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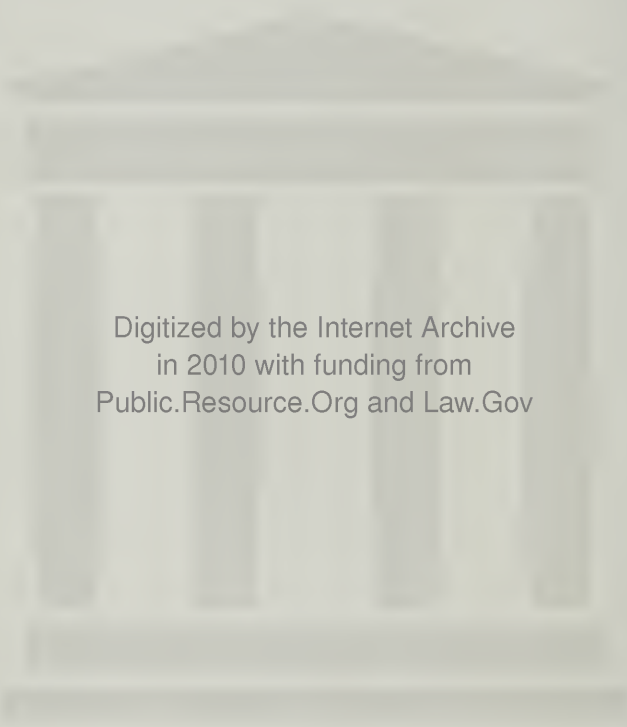
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2983

Nos. 15256-15257

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United States  
Court of Appeals  
for the Ninth Circuit

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MARGUERITE FERRANDO and FRED FERRANDO, co-executors of the Last Will and Testament of Mario Ferrando, deceased;  
EDWARD FERRARI and GEORGE FERRARI, co-executors of the Last Will and Testament of Luigi Ferrari, deceased,

Appellants,

VS.

UNITED STATES OF AMERICA, Appellee.

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Transcript of Record

In Two Volumes

VOLUME II.

(Pages 33 to 225, inclusive)

---

Appeal from the United States District Court for the  
Northern District of California  
Southern Division

FILED

DEC - 3 1956





Nos. 15256 - 15257

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Appeal from the United States District Court for the  
Northern District of California  
Southern Division

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In the United States District Court, Northern  
District of California, Southern Division

No. 34,586

MARGUERITE FERRANDO and FRED FER-  
RANDO, Co-Executors of the Last Will and  
Testament of Mario Ferrando, Deceased,  
Plaintiffs,

vs.

UNITED STATES OF AMERICA, Defendant.

No. 34,587

EDWARD FERRARI and GEORGE FERRARI,  
Co-Executors of the Last Will and Testament  
of Luigi Ferrari, Deceased, Plaintiffs,

vs.

UNITED STATES OF AMERICA, Defendant.

# REPORTER'S TRANSCRIPT

Thursday, March 15, 1956

Before: Hon. Louis E. Goodman, Judge.

Appearances: For the Plaintiffs: Henry W.  
Howard, Esq., 111 Sutter Street, San Francisco,  
California. For the Defendant: Lloyd H. Burke,  
U. S. Attorney, by Lynn J. Gillard, Assistant U. S.  
Attorney. [1\*]

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\* Page numbers appearing at top of page of original Reporter's  
Transcript of Record.

The Clerk: Ferrando versus The United States, Ferrari versus The United States, court trial.

Will respective counsel please state their appearances for the record.

Mr. Howard: Henry W. Howard for the plaintiffs.

Mr. Gillard: Lynn J. Gillard, Assistant United States Attorney for the defendant, United States.

(Opening statements by both counsel.)

### FRED FERRANDO

one of the plaintiffs herein, called as a witness in his own behalf; sworn.

The Clerk: Please state your name to the Court.

The Witness: Fred Ferrando.

### Direct Examination

Q. (By Mr. Howard): Mr. Ferrando, you are one of the plaintiffs in the proceeding now pending before this Court, is that correct?

A. Yes, sir.

Q. You were a co-executor of the last will and testament of your father, Luigi Ferrari — Mario Ferrando?

A. That's right.

Q. And when did your father die, Mr. Ferrando?

A. April, 1947.

Q. Where were you born, Mr. Ferrando?

A. San Francisco. [3]

Q. When?

A. 1911.

Q. Where were you educated?

A. San Francisco.

Q. Where did you go to grade school?



(Testimony of Fred Ferrando.)

A. Portola.

Q. Did you go to high school?

A. Yes, Mission.

Q. Did you graduate from high school?

A. No, I didn't.

Q. What was your father's business, Mr. Ferrando?

A. Concrete contractor.

Q. And were you engaged in that business with your father?

A. Yes, I was.

Q. You carried it on after his death, is that correct?

A. Yes.

Q. Now, Mr. Ferrando, do you know Lloyd J. Cosgrove?

A. Yes.

Q. Did you know him at the time of your father's death?

A. Yes.

Q. How long had you known him at that time?

A. Approximately eighteen years.

Q. Did you ever have any professional relations with him during that period of time?

A. Yes. [4]

Q. In general what did those consist of?

A. Oh, a few minor court cases that he had, legal cases.

Mr. Gillard: I didn't hear that answer.

The Witness: A few minor legal cases that he had handled for me.

Q. (By Mr. Howard): Did Mr. Cosgrove prepare your father's will?

A. Yes.

Q. Do you know when that occurred, approximately?

(Testimony of Fred Ferrando.)

A. Oh, a few months before my dad passed away.

Q. Now, at the time of your father's death, at any time prior to your father's death, had you ever been named executor or administrator of a last will and testament of anyone? A. Yes.

Q. Other than your father?

A. Oh, no; no.

Q. Had you ever been connected in any way with the probate of estates prior to that time?

A. No.

Q. Now, at the time of your father's death, how soon after the time of your father's death did you contact Mr. Cosgrove? A. Immediately.

Q. Did you go to see him? A. Yes.

Q. Was your mother with you?

A. Yes. [5]

Q. What was the nature of the discussion you had with him at that time?

A. About the estate, my father's estate, to handle the estate for us.

Q. Did you employ him for the purpose of representing you as executors?

A. That is correct.

Q. Did Mr. Cosgrove undertake that employment? A. Yes.

Q. At that time did you have any discussion about taxes and all?

Mr. Gillard: Well, pardon me——

A. Yes.

Mr. Gillard: ——Counsel, I object to the ques-

(Testimony of Fred Ferrando.)

tion as being not specific as to time; like to know when this is.

Q. (By Mr. Howard): When did this conversation take place, Mr. Ferrando?

A. I don't remember; first time I went to see him, I believe.

Q. How soon after the death of your father did that occur?

A. Oh, within a week, a few days.

Q. I see. Now, at the time of that conversation was there any discussion about taxes in connection with the administration of your father's estate?

A. Yes. [6]

Q. Now, what did Mr. Cosgrove ask you to do in connection with the administration of that estate? A. I don't remember.

Q. Did he call on you to furnish documents?

A. Oh, yes.

Q. Did you comply with his request?

A. I did.

Q. Do you remember what they related to, in general? A. To the estate of my father.

Q. Now, Mr. Ferrando, I have here in my hand a letter addressed to you under date of February 8, 1949, by Mr. Lloyd J. Cosgrove, and ask you if you have seen that before?

A. Yes, sir, I have.

Q. Received by you from Mr. Cosgrove, is that correct? A. That is right.

Mr. Howard: May I read this into the record, your Honor?

(Testimony of Fred Ferrando.)

Mr. Gillard: Is it being offered in evidence?

Mr. Howard: Yes. This is a letter from the law office of Cosgrove, Molinari & Tinney. It is dated February 8, 1949 and reads as follows:

“Mr. Fred Ferrando,  
815 Thornton Street,  
San Francisco, California.

Dear Mr. Ferrando:

The Federal estate tax return has been prepared. I would, therefore, appreciate your [7] calling with your mother at this office to sign it. Please give this matter your usual prompt attention.

Yours very truly,

Lloyd J. Cosgrove.”

Offer this in evidence.

The Clerk: Plaintiff's Exhibit No. 1. Introduced and filed into evidence.

(Letter referred to was thereupon received in evidence and marked Plaintiff's Exhibit 1.)

Q. (By Mr. Howard): Now, Mr. Ferrando, prior to the receipt of that letter had you had any discussions with Mr. Cosgrove with respect to the Federal estate tax return?

A. I believe I did, yes.

Q. Do you remember specifically when?

A. No.

Mr. Gillard: What is that answer?

The Witness: No.

The Court: No, he said.

Q. (By Mr. Howard): In response to that letter did you go to Mr. Cosgrove's office?

(Testimony of Fred Ferrando.)

A. Yes.

Q. And did you sign the Federal estate tax return? A. Yes.

Q. Was your mother present at that time? [8]

A. Yes.

Q. Did she sign the return? A. Yes.

Q. Now, did Mr. Cosgrove indicate to you at that time that the return was late? A. No.

Q. Did he indicate to you at that time that there was any possibility of penalties involved, or anything of that nature? A. No.

Q. Now, Mr. Ferrando, do you recall the payment of the Federal estate tax called for in that return? A. Yes.

Q. And will you tell us how that was handled?

A. I was called to make this check—I believe it was in the amount of around thirteen, fourteen thousand dollars—and which I did, I made the check out.

Q. And when did this occur?

A. I don't remember the date.

Q. Referring to the exhibit just in evidence, the date is February 8, 1949. Does that refresh your recollection with respect to that time?

A. No, it could be that, though.

Q. What is that?

A. It could be that date; I really don't remember the date.

Q. Who asked you to furnish the check? [9]

A. Mr. Cosgrove.

Q. Did he call you personally? A. Yes.



(Testimony of Fred Ferrando.)

Q. Did he ask you to mail the check?

A. No.

Q. What did he say?

A. He told me to make the check out, leave it at my office and send someone out to pick it up.

Q. And the check was then picked up?

A. Yes.

Q. Who picked it up, do you know?

A. I believe Mr. Cosgrove picked it up.

Q. Now, Mr. Ferrando, when did you first have knowledge that this return was filed late and that there was a probability of penalties involved?

A. The day that the Internal Revenue man called me, I believe his name is Mr. Holmes, he called me, and I wasn't there. I got the message and called Mr. Cosgrove. Mr. Cosgrove told me to come down and see him. I saw Mr. Cosgrove, he told me to go see his attorney. That is when I found out about that.

Q. Is that the first time you had any knowledge of those circumstances?      A. That's right.

Mr. Howard: Care to cross-examine? [10]

### Cross Examination

Q. (By Mr. Gillard): Mr. Ferrando, how long had you been in the concrete business with your father prior to his death?

A. Approximately fifteen years.

Q. That was a partnership, was it?

A. Yes, sir.

Q. What were your duties as a partner?

(Testimony of Fred Ferrando.)

A. I handled everything.

Q. You handled estimating? A. Right.

Q. And bidding on jobs?

A. That is correct.

Q. Ordering of materials? A. Right.

Q. Payment of bills? A. Right.

Q. Running of the office? A. That's right.

Q. Making the tax returns? A. No.

Q. Who made the tax returns?

A. My accountant.

Q. Your who? A. My accountant.

Q. Your accountant. In connection with that business, what [11] kind of taxes, local, State and Federal, were you required to pay?

A. I don't remember.

Q. Don't you remember any of them, Mr. Ferrando? A. You are talking about amounts?

Q. No, the——

The Court: What kind of taxes?

The Witness: Oh, yes, excuse me. State tax, Internal Revenue tax.

Q. (By Mr. Gillard): Well, let's see, you were required to have a City license, weren't you?

A. Oh, yes.

Q. And that had to be renewed annually?

A. Yes.

Q. You knew that was on a yearly basis?

A. Yes.

Q. You had to pay real estate taxes locally?

A. No, not real estate business.

The Court: No, but what he means, did you own

(Testimony of Fred Ferrando.)

any real estate on which you had to pay taxes?

The Witness: Oh, yes; yes, sir.

Q. (By Mr. Gillard): Those are paid annually likewise, aren't they? A. Yes.

Q. Then for the State you had certain withholdings from the [12] wages of your employees, unemployment compensation? A. That's right.

Q. How were those returns made?

A. Well, the girl in the office takes care of all that.

Q. What period of time was the reporting period for the withholding taxes on unemployment for the state?

A. I believe it is quarterly, I think.

Q. That's to the Franchise Tax Commissioner, is it? A. I think so.

Q. Did you pay any other State taxes?

A. No.

Q. State income taxes? A. Oh, yes.

Q. What was the reporting period for State income taxes? A. Yearly.

Q. Yearly. What kind of Federal taxes did you pay? A. Yearly.

Q. Those included social security taxes for employees? A. Yes.

Q. Withholding, wage withholding taxes for the employees? A. I believe so.

Q. And your own income taxes?

A. That's right.

Q. All those were reported annually?

A. Right. [13]

(Testimony of Fred Ferrando.)

Q. So that you are familiar with the fact that with reference to taxes in general there are certain definite periods provided by law that tax returns are to be due, is that correct?

A. Not thoroughly familiar.

Q. Well, with respect to the taxes you have referred to, were you thoroughly familiar with that fact?

A. I know we have those taxes, we have to take care of that, I know.

Q. And you know——

A. But I have very little to do with it. In fact, none at all but sign the check.

Q. You knew the fact that these were taxes which are required to be reported at regular periodic intervals?

A. Yes.

Q. Now, when you went to see Mr. Cosgrove that very first day that you saw him after your father's death, I believe you testified that on that occasion you had talked to him about taxes, is that correct?

A. Yes.

Q. What did you talk about, Mr. Ferrando?

A. Estate tax.

Q. What about the estate tax?

A. Well, I wanted him to handle the, my father's estate, take care of the whole thing.

Q. Well, specifically with reference to estate taxes, what [14] did you talk about?

A. I don't remember.

Q. Did you ask him if an estate tax was going

(Testimony of Fred Ferrando.)

to be required to be paid in connection with this estate?

A. It is pretty hard for me to remember that, sir.

Q. Did you ask him when a return, a tax return would be due in the estate?

A. I don't remember.

Q. Do you have any recollection about that at all, Mr. Ferrando?      A. Not too much.

Q. Did you at any time prior to the receipt of Exhibit No. 1 ask Mr. Cosgrove about an estate tax return and when it should be filed in connection with your father's estate?

A. Yes, I believe I asked him, he told me that he would take care of the matter.

Q. When was this and what was it?

A. Matter of my father's estate.

Q. Yes, you asked him to take care of your father's estate, and he said he would take care of it, is that correct?      A. That's right.

Q. Did you inquire of anybody else outside of Mr. Cosgrove about your responsibilities to prepare and file an estate tax return with the Internal Revenue Service?      A. No, sir, I didn't. [15]

Q. You did not, sir?      A. No, sir.

Q. Do you recall at any time it came to your attention that you were required to file an estate tax return fifteen months after your father's death?

A. No, I don't remember; I don't remember.

Q. You don't know?      A. That's right.



(Testimony of Fred Ferrando.)

The Court: You must have known that you had to pay taxes on your father's estate.

The Witness: Yes, sir.

The Court: You had that much knowledge?

The Witness: Yes.

The Court: Did the lawyer tell you when you had to pay the tax?

The Witness: Well, I was depending on him, that's why I hired the man.

The Court: But he didn't, did he tell you when you had to pay the taxes?

The Witness: No, he didn't tell me when I had to pay them.

Q. (By Mr. Gillard): In connection with the estate, do you recall that an inheritance tax appraiser was appointed for the purpose of making an inventory of the properties of the estate and placing a value on those properties? [16]

A. That I do.

Q. And do you recall that in that connection an inventory and appraisement were made by an appraiser of the estate?

A. I remember.

Q. And that was filed in connection with the estate?

A. I believe it was.

Q. You signed it also, is that correct?

A. Yes.

Q. I will show you, Mr. Ferrando, file No. 109,-505, in the files of the Superior Court for the State of California, in and for the City and County of San Francisco. I will direct your attention to a document entitled "Inventory and Appraisement,"

(Testimony of Fred Ferrando.)

second page of which contains an oath of appraiser, and the third page of which contains the oath of executors with two names signed to it, one of which is Marguerite Ferrando, and one of which is Fred Ferrando and ask if you will identify that as——

A. Yes.

Q. ——your signature? A. Yes.

Q. That is the inventory and appraisement which was filed at that time in the estate of your father? A. Yes.

Q. Now, what is the date of the notarial acknowledgments on your signature on that inventory and appraisement, Mr. Ferrando? [17]

A. Fourteenth day of October, 1948.

Q. And would you say that is the date upon which it was signed? A. I believe so.

Q. Do you have any recollection that it was signed on any other date except as dated by the notary? A. No.

Q. Now, sir, at that time that that inventory and appraisement was filed, did you inquire of Mr. Cosgrove about the filing of a Federal estate tax return?

A. I don't remember if I—I know this, that I had called him on the telephone and asked him if the estate was finished yet and he said everything is being taken care of. I just left it at that.

Q. I gather in general that your relationships with Mr. Cosgrove in connection with this estate was that you would make inquiries as to how things were coming along, and he would say everything

(Testimony of Fred Ferrando.)

was being taken care of?           A. That's right.

Q. You were not aware that at the time this inventory and appraisal was filed that the time for filing of the Federal estate tax return had already expired?

A. No, sir, I wasn't aware of it.

Q. You didn't call that to Mr. Cosgrove's attention nor ask him any questions about it? [18]

A. No, I didn't.

Q. Now, sir, I will ask you——

Mr. Gillard: I will ask this to be marked, this check to be marked for identification.

The Clerk: Defendant's Exhibit A marked for identification.

(Check dated July 15, 1948 in the sum of \$14,525.69 was received and marked Defendant's Exhibit A for identification only.)

Q. (By Mr. Gillard): I will show you Defendant's Exhibit A for identification, Mr. Ferrando, which is a check in the amount of \$14,525.69, and ask you if you can identify that check?

A. Yes, that's my check.

Q. Are the figures I just read in your handwriting?           A. Yes, sir.

Q. And the payee, the Collector of Internal Revenue, in your handwriting?           A. That's right.

Q. And the signature?           A. Correct.

Q. F. Ferrando?           A. That's right.

Q. That check bears a typewritten date of July 15, 1948.           A. That's right. [19]

Q. Did you insert that date in there, Mr. Fer-

(Testimony of Fred Ferrando.)

rando?           A. No, sir, I did not.

Q. When you made out the check you did so at the request of Mr. Cosgrove?           A. Yes.

Q. Did Mr. Cosgrove request that you leave the date of the check blank?

A. I don't remember that incident. I remember him telling me to make the check out.

Q. Do you recall why you did not insert the date on the check?           A. I don't recall.

Q. Do you know when that check was actually drawn, Mr. Ferrando?

A. Well, the stub on the checkbook will indicate that.

Mr. Gillard: I will ask to be marked for identification this book of check stubs. The only one to which we will have reference will be check No. 8860.

Q. Is the number on that check in front of you on Exhibit A No. 8860, Mr. Ferrando?

A. That's right.

Mr. Gillard: Ask this checkbook stub be marked Exhibit B.

The Clerk: Defendant's Exhibit B marked for identification.

(Checkbook stubs received and marked Defendant's Exhibit B for identification only.)

Q. (By Mr. Gillard): I show you Defendant's Exhibit B for identification, Mr. Ferrando, and refer particularly to and ask you first what is this Exhibit B for identification?

A. This is the stub that belongs to this check.

(Testimony of Fred Ferrando.)

The Court: That's the stubs of your checks, is that correct?

The Witness: That's right.

Q. (By Mr. Gillard): And the entry made opposite check No. 8860 is that in your handwriting, sir? A. Yes, sir.

Q. Was that made on the date you wrote the check? A. Right.

Q. What date is the entry on your check stub record? A. February 17, 1949.

Mr. Gillard: I will offer into evidence Exhibits A and B, if the Court please.

The Court: Admitted.

(Defendant's Exhibits A and B heretofore marked for identification only, were received and marked in evidence.)

Q. (By Mr. Gillard): Now, do I gather the sequence of events in this transaction, Mr. Ferrando, was that you received this letter from Mr. Cosgrove, Exhibit No. 1, that's dated February 8. Do you recall when you received that letter?

A. Gee, I don't. [21]

Q. Upon receipt of that letter did you go with your mother to Mr. Cosgrove's office and execute an estate tax return, sign your names to an estate tax return? A. Yes.

Q. Was that prior to the time you drew this check, Defendant's Exhibit A?

A. I don't remember.

Q. Well, did you draw this check, Exhibit A, after you had been to Mr. Cosgrove's office and



(Testimony of Fred Ferrando.)

signed the tax return?      A. I don't remember.

The Court: Must have been on or about that time, is that right?

The Witness: Must have been, yes.

Q. (By Mr. Gillard): Where did you get the amount to insert in the check, Exhibit No. A?

A. Mr. Cosgrove gave me the amount over the telephone.

Q. When you signed the tax return, did you notice what the amount of the tax that was due?

A. Probably I did at the time, but I don't remember the amount.

Q. When your tax return was presented to you, for signature, did you look through it to determine the amount of the tax that was due?

A. I am not sure, I don't remember whether I did or not.

Mr. Gillard: If the Court please, I have here the original [22] estate tax return in the estate of Mario Ferrando and also a photostatic copy of the same. With the consent of counsel I will have marked for identification the photostatic copy.

The Court: Very well.

The Clerk: Defendant's Exhibit C marked for identification.

(Whereupon photostatic copy of estate tax return of estate of Mario Ferrando marked Defendant's Exhibit C for identification only.)

Q. (By Mr. Gillard): I will hand you Defendant's Exhibit C for identification and ask you if you can identify that document, Mr. Ferrando, di-

(Testimony of Fred Ferrando.)

recting your attention particularly to the next to the last page thereof, which is the signature page.

A. That's my signature.

Q. Would you prefer to see the original document for comparison purposes, Mr. Ferrando? It might help you.

A. That is my signature, too.

Q. Is Exhibit C, the photostatic copy, a copy of the original return which I am now showing you?

A. Yes.

Q. Is that the return you signed in Mr. Cosgrove's office after receiving Plaintiff's Exhibit No. 1, this letter?

A. I think so, yes.

Q. And who was present at the time you signed that return, Mr. Ferrando?

A. Mr. Cosgrove and my mother.

Q. Was Ruth Cosgrove, the notary, present?

A. No. [23]

Q. What is the date of the notarial acknowledgment on that return?

A. 15th day of July, 1948.

Q. Was that the day the return was signed?

A. I don't remember.

Q. Was that date on the return when you signed it, Mr. Ferrando?

A. I am not sure, I don't remember.

Q. You don't remember that? A. No.

Q. It could have been on there?

A. It could have been.

Q. That is the same date that is on your check, Defendant's Exhibit A, is that correct, July 15, 1948?

(Testimony of Fred Ferrando.)

The Court: Well, it shows that.

Q. (By Mr. Gillard): I will refer you to the third from the last page on the exhibit showing the net estate tax payable, \$14,525.69. At the time you signed the return did you notice that total amount of tax due? A. I don't remember, sir.

Q. Your best recollection is that the amount of the tax that was payable you secured from Mr. Cosgrove on the telephone after you had signed the return, is that correct? A. Yes.

Mr. Gillard: I will ask that Defendant's Exhibit C be [24] admitted into evidence.

The Court: Admitted.

The Clerk: Defendant's Exhibit C admitted into evidence.

(Whereupon Defendant's Exhibit C heretofore marked for identification only was received and marked in evidence.)

Q. (By Mr. Gillard): At the time you went to Mr. Cosgrove to employ him as an attorney, as the attorney in this estate, did you ask him with reference to his prior experiences in handling estates and Federal estate tax returns?

A. No, sir, I did not.

Q. Did you make any inquiry of anybody else as to Mr. Cosgrove's expert knowledge and ability to handle and file Federal estate tax returns?

A. No, sir, I didn't.

Q. Now, this check, Defendant's Exhibit A, was eventually returned to you from your bank?

A. Yes.



(Testimony of Fred Ferrando.)

Q. At the time that you received it back, Mr. Ferrando, did you notice that the date July 15, 1948, had been inserted on it? A. No.

Q. You did not notice that? A. No.

Q. When was the first time you became aware of the fact [25] that that date had been inserted on that check?

A. At the first trial, I believe, when it came up for exhibit.

Q. You are referring to the criminal trial involving Mr. Cosgrove? A. That is right.

Q. You never, I gather, then, at any time asked Mr. Cosgrove about the back-dating of your check?

A. No, I haven't, sir.

Q. If I understand you properly it is your testimony that you don't recall whether or not you left this date blank because you merely failed to put the date in, you deliberately left it out, or Mr. Cosgrove told you to leave it out, is that correct?

A. That's right.

Q. You have no recollection about it whatsoever? A. No, sir.

Q. Is it an ordinary practice of yours——

A. No, sir, it isn't.

Q. ——to omit the dates from checks?

A. No, sir.

Q. Don't you have any recollection at all, Mr. Ferrando, about that date?

A. Only thing I can remember, sir, is Mr. Cosgrove called me during the noon hour, asked me to make this check out, gave [26] me the amount, I

(Testimony of Fred Ferrando.)

made the check out, the date was left off, I don't remember him telling me to leave the date out.

Q. Did he tell you at that time that the return was late?           A. No, sir.

Q. Now you have received, have you, Mr. Ferrando, from Mr. Cosgrove an indemnity in the event that you are unsuccessful in this action for a refund of these penalties?

Mr. Howard: I object to that question, your Honor. I don't think it is at all material or relevant to the issues involved in this proceeding. The question here is whether there is reasonable cause as respects these plaintiffs for the late filing of these returns.

The Court: Well, it might have some relevance in relation back as to the circumstances under which the return was made and the check made out. I will overrule the objection.

Q. (By Mr. Gillard): Do you have the question, Mr. Ferrando?

A. Do I understand you are asking whether I have a letter from Mr. Cosgrove saying that he would reimburse me for penalties that are paid out?

Q. That is correct.           A. Yes.

Q. You have that with you?

A. I don't have it.

Q. Your attorney has it?           A. Yes. [27]

Q. Do you recall when that was executed?

A. I do not remember, sir.

Q. Was it executed prior to the institution of this action?           A. Oh, no.

(Testimony of Fred Ferrando.)

Q. Do you know when this action was filed, sir?

A. No.

Q. Let me put it this way to you: Was it executed——

A. I think——

Q. Was it executed prior to the time you filed a claim with reference to the refund of the taxes with the Internal Revenue Service?

A. Sir, I believe I received that letter the day that—paid the penalties.

Q. The day you paid the penalties?

A. Yes, I believe that is the day we received the letter, or a day after.

Q. Had you paid penalties on one or more than one occasion?

A. One occasion. I believe the amount is \$4800, somewheres near there.

Q. Didn't you pay a certain amount——

The Court: Isn't there a record as to when they were paid? I notice the complaint alleges penalties were paid on two occasions.

Mr. Gillard: That is correct, your Honor. They were within a very short time of each other. Will it be stipulated, [28] Counsel, these penalties the witness is now referring to, those alleged in the complaint, as having been paid on the 19th day of December, 1951—I beg your pardon, on the day I have here is February 19, 1951, is that the date?

Mr. Howard: So stipulated, your Honor.

The Court: They were paid on December 23, 1951 and January 4, 1952.

(Testimony of Fred Ferrando.)

Mr. Gillard: That is correct, your Honor, December 23, 1951 and January 4, 1952.

Q. (By Mr. Gillard): It was about that time, is that correct, that Mr. Cosgrove executed an indemnity agreement to repay to you the amount of those penalties in the event that you did not recover them back? A. That's right.

Q. In connection with that agreement did you agree to file an action for a refund of those penalties? A. Yes.

Q. And that claim for refund was actually filed by you, or signed by you on December 10, 1952, is that correct? A. Yes, sir.

Mr. Gillard: Will you mark this for identification?

The Clerk: Defendant's Exhibit D marked for identification.

(Whereupon claim received and marked Defendant's Exhibit D for identification only.)

Q. (By Mr. Gillard): I will show you Defendant's Exhibit D [29] for identification, Mr. Ferrando, which is a claim for refund, and ask you if that is your signature on the bottom of it?

A. Yes, it is.

Q. That was dated by you on December 10, 1952.

A. That is not my writing, my initial, that is my initial.

Q. The December 10 — there was an original date typewritten on the face of the claim of November 6, is that correct? A. Yes.

(Testimony of Fred Ferrando.)

Q. That was stricken out and December 10 written over it and you initialled the change?

A. That is right.

Q. And then your signature is on the right-hand side?

A. That's right.

Q. Along with your mother's.

A. That's right.

Mr. Gillard: Ask this be admitted in evidence as next in order.

The Court: Admitted.

The Clerk: Defendant's Exhibit D admitted into evidence.

(Whereupon Defendant's Exhibit D heretofore marked for identification only was received and marked in evidence.)

Q. (By Mr. Gillard): That claim then was filed by you and your mother pursuant to your agreement with Mr. Cosgrove that you attempt to recover from the United States the amount of [30] penalty that you had paid, and the agreement with him was, and is right now, that in the event you are unsuccessful in collecting this amount back from the United States Mr. Cosgrove will pay that amount to you?

A. That is right, sir.

Mr. Gillard: I have no further questions. One further question, Mr. Ferrando.

Q. (By Mr. Gillard): In this entire transaction of handling the estate of your father as between yourself and your mother, you were the one—you're quite a bit younger than your mother?

A. That's right.



(Testimony of Fred Ferrando.)

Q. And you were the one that was actually handling the business relations with Mr. Cosgrove?

A. That is right.

Q. Your mother merely did everything you told her to do? A. That is right.

Q. And she had little or no direct contact with Mr. Cosgrove? A. That is right, sir.

Q. Whatever there is that is known about the affairs of the estate and the matter of delivery of information to Mr. Cosgrove or seeking information from him, you were the moving spirit in that?

A. That is right.

Q. And you were the spokesman for the two of you? [31] A. That is right.

Mr. Gillard: Thank you.

#### Redirect Examination

Q. (By Mr. Howard): Mr. Ferrando, I have here the file in the Superior Court, City and County of San Francisco, Probate No. 109,505, which Mr. Gillard has shown you before. Now, this file contains a number of documents bearing the signature of yourself and Mrs. Ferrando, and I show a petition for probate of the will and issuance of letters testamentary. A. Yes.

Q. Is that your signature on there?

A. Yes.

Q. The signature of your mother?

A. That's right.

Q. And that was signed by you at the request of Mr. Cosgrove? A. That's right.

(Testimony of Fred Ferrando.)

Q. In his office? A. Yes.

Q. I have here the letters testamentary which were issued in that proceeding; is that your signature there? A. That's right.

Q. And that is the signature of your mother?

A. That's right.

Q. And you recall that that was signed at the courthouse in San Francisco? [32] A. Yes.

Q. Was Mr. Cosgrove present at that time?

A. Yes.

Q. Now, the inventory—here's a petition to establish the fact of death and determining joint tenancy, which was filed in this proceeding, and it is signed by Marguerite Ferrando; that is your mother? A. That is right.

Q. Were you present when she signed that?

A. I don't remember, but I must have been.

Q. Now, this document contains a number of legal descriptions of property. A. Yes.

Q. Do you know whether you furnished those to Mr. Cosgrove? A. No.

Q. Now, all the documents contained in this file were signed by you at the request of Mr. Cosgrove, is that correct? A. That's right.

Q. And in his office? A. Yes.

Q. Now, I have here the inventory and appraisal that Mr. Gillard referred to and which he showed to you a few minutes ago. That likewise contains a description of a number of parcels of real property of your father's estate?

A. Yes. [33]

(Testimony of Fred Ferrando.)

Q. Did you furnish Mr. Cosgrove those legal descriptions of deeds, do you recall?

A. I think we did give him the deeds, yes, sir.

Q. Now, the first time that you were asked to sign Federal estate tax returns was the time you received this letter in evidence as Plaintiff's Exhibit No. 1 for Mr. Cosgrove, is that correct?

A. I believe it is, yes.

Q. You responded promptly to this request, is that your best recollection? A. Yes.

Mr. Howard: I have no further questions of this witness.

Mr. Gillard: No further questions.

The Court: That's all.

(Witness excused.)

Mr. Howard: Mrs. Ferrando.

### MARGUERITE FERRANDO

one of the plaintiffs here, called as a witness in her own behalf; sworn.

The Clerk: Please tell the Judge your name.

The Witness: Marguerite Ferrando.

### Direct Examination

Q. (By Mr. Howard): Mrs. Ferrando, you are the Marguerite Ferrando who is named as a plaintiff in the proceedings now? A. Yes. [34]

Q. In this court, is that correct? You are the widow of Mario Ferrando, who died on April 22, 1947, in San Francisco? A. Yes.

Q. And you are named in his will as a co-executor of that will, is that correct? A. Yes.



(Testimony of Marguerite Ferrando.)

Q. Where were you born, Mrs. Ferrando?

A. Montevideo, South America.

Q. When did you come to this country?

A. Oh, about 1900, I guess; 1900.

The Court: What was your name, maiden name?

The Witness: Carrero.

The Court: You are not of Italian descent?

The Witness: Oh, yes, Italian.

The Court: Your parents were Italian; they lived in Uruguay?

The Witness: They lived very little in South America.

The Court: Only a short time?

The Witness: A short time.

Q. (By Mr. Howard): How old were you when you came to San Francisco?

A. I was about ten or eleven, something like that.

Q. Did you go to school in this city?

A. San Francisco.

Q. Did you go to grammar school here? [35]

A. Yes.

Q. You recall where?

A. Southland School, out in the Portola District.

Q. Did you have any education beyond that point? A. No.

Q. When did you marry Mario?

A. In 1909.

Q. Where did you live at that time?

A. Used to be Charter Oak at that time, Charter Oak Avenue; now it's Bayshore.

(Testimony of Marguerite Ferrando.)

Q. That's in the Portola District?

A. Portola District.

Q. You lived there until the time your husband died?

A. Oh, yes.

Q. At the time of your husband's death, did you know Lloyd J. Cosgrove?

A. Yes.

Q. Did you know of his reputation in the community?

A. Yes.

Q. What was your understanding of his reputation at that time?

A. That he was good; he was all right.

Q. Now, you went to Mr. Cosgrove with your son?

A. Yes.

Q. Fred, at the time of your husband's death?

A. Yes.

Q. You employed him to probate the will and to administer the estate, is that correct?

A. That's right.

Q. Now, did you actively participate with your son in the problems relating to the probate of the estate, Mrs. Ferrando?

A. Yes, always with my son.

The Court: Why don't you reword that a little more simply? That is pretty much of a lawyer's question.

Q. (By Mr. Howard): Mrs. Ferrando, in dealing with Mr. Cosgrove in matters relating to the estate, was it your son who carried on most of that?

A. Yes, it was my son.

Q. And you just appeared at times when Mr. Cosgrove requested it, is that it?

(Testimony of Marguerite Ferrando.)

A. That's right.

Q. You signed documents he presented to you for signature? A. Yes.

Q. Now, do you recall, Mrs. Ferrando, signing a Federal estate tax return in Mr. Cosgrove's office?

A. Yes, I signed something, I don't remember.

Q. You don't remember specifically the nature of the document? A. No.

Mr. Howard: I have no further questions. [37]

Cross Examination

Q. (By Mr. Gillard): Mrs. Ferrando, you went to Mr. Cosgrove's office whenever your son told you you should go down there? A. Yes.

Q. And you relied upon him for the conduct of your duties as executrix of the estate, did you not?

A. Yes.

Q. And anything he asked you to do you did?

A. Yes.

Q. Anything Mr. Cosgrove told you to do you did? A. Yes.

Q. You didn't ask any questions of anybody?

A. No.

Q. You just signed the papers?

A. Yes, that is right, what he told me.

Mr. Gillard: Thank you.

The Court: That is all?

Mr. Howard: That is all.

(Witness excused.)

Mr. Howard: Your Honor, that completes the testimony of the Ferrando case, except for such

testimony as Mr. Cosgrove will give in that proceeding.

The Court: Do you want to put him on once, is that it?

Mr. Howard: Put him on once after the Ferrari testimony [38] is in so that he could cover both situations at one time.

The Court: Is that agreeable to you?

Mr. Gillard: There is apt to be a little confusion. If the Court wants to try it——

The Court: I won't have any trouble following it, I'm just wondering whether making the record in that way would be satisfactory to both you people. There is a common ground of testimony, of course, because the facts are the same and the law——

Mr. Gillard: The only possibility of confusion on the record would be in the event there is an appeal, you would have to break up his testimony and designate it, but that would be no onerous burden.

The Court: Well, it may be for the sake of accuracy you might conclude—you could take the lawyer's testimony with respect to the Ferrando case, and then after you do that make him the first witness with regard to the other case. Is that what you had in mind, to save the reappearance?

Mr. Howard. Yes.

The Court: Would that be all right?

Mr. Gillard: Yes.

The Court: Do you have any testimony yourself in the Ferrando case?

Mr. Gillard: No, I don't believe so, your Honor.

The Court: I just asked that so we can keep the record [39] straight. Go ahead, then.

Mr. Howard: Shall we proceed at this time?

The Court: Yes.

Mr. Howard: Mr. Cosgrove.

LLOYD J. COSGROVE

called as a witness by the plaintiffs, sworn.

The Clerk: Please state your name to the Court, sir.

The Witness: Lloyd J. Cosgrove, 2811 Mission Street, San Francisco.

Direct Examination

Q. (By Mr. Howard): Mr. Cosgrove, what is your profession? A. Attorney-at-law.

Q. How long have you practiced your profession?

A. Close to thirty years in San Francisco.

Q. Where is your office located?

A. 2811 Mission Street, San Francisco.

Q. You recall when you were admitted to practice? A. March of 1926.

Q. Now, in the course of your professional practice did you handle the probate of estates?

A. I have.

Q. In the course of probating estates were you familiar with the requirements of the law relating to inheritance and estate taxes?

A. I believe I was. [40]

Q. Now, did you know Mario Ferrando?

A. I did.



(Testimony of Lloyd J. Cosgrove.)

Q. Did you prepare his last will and testament?

A. I believe I did.

Q. And after his death were you employed by the co-executors of that will, Fred Ferrando and Marguerite——

A. I was.

Q. In probating the estate? Do you recall when you were employed?

A. No, but I understand the file is here, and if I were to look at the file I could get the approximate date.

Q. Was it shortly after the death of Mario Ferrando?

A. I would say it was shortly after the death of Mr. Ferrando.

Q. Did Mr. Ferrando and his mother appear in your office?

A. I believe they did.

Q. At that time did you outline to them the responsibilities you would assume in the probate of the estate?

A. No, I don't think I did outline, I have no independent recollection as to what did take place, but the normal procedure and the procedure that I followed at that time and still follow, is that the person comes in and wants me to handle the estate, I tell them I would take care of it and finish the job for them. I wouldn't outline to them procedures or steps that are required.

Q. Did you have any discussion with them about taxes at that [41] time that were involved in this estate?

A. I have no recollection on it.

(Testimony of Lloyd J. Cosgrove.)

Q. You undertook, then, to probate the estate in all its aspects, is that it?

A. I assumed the obligation of probating and finishing the administration of that estate.

Q. Including the responsibility for the preparation of the inheritance tax returns?

A. I did.

Q. Inventory and appraisements?

A. The complete administration of that estate I assumed when I assumed the responsibility of filing the petition for probate of the will and I contemplated and figured on carrying it to a completion and do everything that was necessary to be done in the administration of that estate.

Q. Now, in the course of probating of the estate you had occasion from time to time to contact Fred Ferrando?

A. I did.

Q. And for what purpose?

A. Well, the first thing, contacted him for the filing of the petition for probate of will. Next we contacted them for appointment to go into court. Next we contacted him for the gathering and marshalling of the assets, and at various times contacted them, as steps were taken on the administration of the estate I would contact them and present what was necessary. [42]

Q. Now, did Mr. Ferrando respond to the various requests for assistance?

A. I would say he did.

Q. In other words, you received cooperation from him in this connection?



(Testimony of Lloyd J. Cosgrove.)

A. Full cooperation.

Q. Now, with respect to the Federal estate tax return, which is in evidence in this proceeding, did you have any conversations relating specifically to the Federal estate tax return with Mr. Ferrando prior to the time you addressed a letter to him under date of February 8, 1949, advising him that the return had been prepared?

A. I have no recollection of any conversations with him prior to that date.

Q. Now, in response to your letter, which is in evidence as Plaintiff's Exhibit No. 1, Mr. and Mrs. Ferrando came to your office, is that correct?

A. That is right.

Q. And while there you presented to them a Federal estate tax return?

A. I believe that is correct.

Q. And they signed that return in your presence?

A. I believe so.

Q. Was there anyone else present at the time?

A. Not that I can recall. [43]

Q. At that time, at the time of that conversation, or any prior conversations or any subsequent conversations between you and Mr. Ferrando, was there any discussion relating to the fact that that return was then delinquent?

A. None prior to, none at that time, but subsequently and quite a while afterwards when we were in court here, yes, but not prior to that time.

Q. Now, did you at any time advise Mr. Fer-

(Testimony of Lloyd J. Cosgrove.)

rando prior to the time that you were in court here that the return was in fact delinquent?

A. No, and I never considered it delinquent.

Q. You say you never considered it delinquent?

A. That's correct.

Q. And why was that, will you explain that?

Mr. Gillard: Object to that as incompetent, irrelevant and immaterial.

The Court: That would call for his opinion and conclusion. You can have testimony as to any facts, what was said and done, but the answer you call for there would be argumentative.

Q. (By Mr. Howard): Was it your understanding at the time Mr. and Mrs. Ferrando were in your office that the return was then delinquent in the sense that the due date as might have been extended was then past?

Mr. Gillard: Object to that as incompetent, irrelevant and immaterial and contrary to the theory of the action and [44] claim for refund filed in this action, that this is a delinquent return that has been filed. What his understanding of the law is is completely beside the point.

The Court: I think that is true. What are you now trying to get at, Mr. Howard?

Mr. Howard: Well, the legal question presented here is whether these penalties were due.

The Court: That is the legal question. Are you asking him whether he knew that the time within which the return fixed by regulation and statute

(Testimony of Lloyd J. Cosgrove.)

for its filing had gone by? I take it that he must have known that.

Mr. Howard: Let's put it this way, your Honor, please:

Q. Did you know, then, Mr. Cosgrove, at the time this return was signed by Mr. and Mrs. Ferrando that the time for filing the return as fixed by the law and the regulations had passed?

A. Rather difficult for me to answer that question, Your Honor.

The Court: I take it you must have known because of the fact the return was predated.

The Witness: I could answer that in this manner: I knew that the Revenue Act provided that the return should be filed within fifteen months period and it was after that period of time.

Q. Did you have any extension of time to file?

A. I did. [45]

Q. To file a return after that date?

A. I did.

Q. You did?           A. Yes.

Q. From whom did you obtain that extension of time?

A. Mr. Paul Doyle, Internal Revenue.

Mr. Gillard: If your Honor please, I will move to strike the last two questions and answers on the ground that the theory behind those questions must stand behind the claim in this case. The claim, which is Exhibit D is:

"Claimants therefore contend that the failure of the estate to make and file the Federal estate tax

(Testimony of Lloyd J. Cosgrove.)

returns required by Section 821 of the Internal Revenue Code within the time prescribed by law (on or before July 20, 1948) was, as respects themselves, and all persons interested in the estate as beneficiaries, legatees and devisees thereof, due to reasonable cause and not to willful neglect."

And the complaint is couched in the theory that the return was filed delinquent.

The Court: You didn't file the claim for refund on the basis that the return was in fact not delinquent?

Mr. Howard: No, we filed the claim for refund on the basis that the return was in fact delinquent and we are not contending here for the purpose of this examination that the [46] return was timely filed.

Now, the theory of the Government's attack on this case, as I understand it, is that the failure to file was not due to reasonable cause and that the neglect, if there was neglect, on the part of the attorney should be borne the responsibility—the responsibility should be borne by the plaintiffs in this case and that there was not good faith.

The Court: Well, of course, what you are really—I am not attempting to discuss the legal aspect of it now, but what you are really saying and have in mind there is that if this were a case in which, between the executor and the attorney, the attorney might for neglect and failure to perform his legal duty with respect to the administration of the estate, the attorney might assert a defense that in

(Testimony of Lloyd J. Cosgrove.)

fact he relied on some other facts and circumstances, or other persons, and that in fact he had a justifiable excuse for his delay in the matter. I am not certain, however, how that would apply on the claim for refund of the estate. I don't know whether I make myself clear on that. That is another aspect. What might be admissible in evidence, for example, by way of defense in a suit against the attorney for improper performance and duties, might not be material in the suit for refund of taxes, of a penalty on the ground that there was justifiable excuse.

Mr. Gillard: I renew my motion to strike the last two questions and answers, if the Court please.

The Court: I don't know whether they have been answered.

Mr. Gillard: The last two questions and answers.

The Court: Were there answers?

Mr. Gillard: There were answers. He said he had an extension from Mr. Paul Doyle.

The Court: Until that is clarified by some further foundation or other questions I will grant the motion. You can cover it again, if you wish to.

Q. (By Mr. Howard): Mr. Cosgrove, during the course of the administration of this estate and prior to the filing of the Federal estate tax return, did you have any conversations with Mr. Paul Doyle, the then Deputy Collector, or Chief Deputy Collector of the Internal Revenue?

A. I did.

Q. What was the nature of those conversations?



(Testimony of Lloyd J. Cosgrove.)

Mr. Gillard: Object to that as incompetent, irrelevant and immaterial, and hearsay.

Q. (By Mr. Howard): But you did have——

The Court: I will allow the witness to answer the question so that we can have a record, and then I'll rule on a motion to strike. I could better determine the real competency on some fact statement, real competency of the testimony on some fact statement. He may answer subject to a motion to strike.

A. Prior to the date that the Federal estate tax return was [48] to be filed, as provided by the regulations, I called Mr. Paul Doyle and told him that I had such an estate and a return would be due on such a date, and that through the pressure of business in the office we weren't able to get it out. I was then told to bring in the return when I did have time to prepare it and file it. I consider that an indefinite extension of time, an oral extension of time to file it.

I knew the regulations provided the fifteen month period. I knew that you can go there and make an affidavit and get your extension of time. But in my practice I communicate with the attorneys over the telephone every day of the week and get extensions of time, and I take their word and they take my word, and that's all. We handle that as we would handle any other pleading in a civil case involving the civil courts of San Francisco, to secure an extension of time in which to file.

Q. Now, Mr. Cosgrove——

(Testimony of Lloyd J. Cosgrove.)

Mr. Gillard: Now, on the basis of that, your Honor please, I move to strike on the ground that the intendment of this type of testimony is to show that the return was timely filed. The witness is asserting that this was in the normal course of his business, a normal extension which he could rely on. I assert that that is not the foundation of this action and it can not possibly be the foundation of this action as filed, and therefore this testimony is incompetent, irrelevant and [49] immaterial, and move to strike the same.

The Court: This answer may involve the precise point on which you rely in this case.

Mr. Howard: If your Honor please——

The Court: And perhaps should stand for the time being. I don't know yet, until I get all of the evidence, whether it has any relevancy to the question of reasonable excuse for delinquency. It might, I don't know yet. I think the Court oughtn't to pass judgment on that. I will reserve ruling on your motion to strike and raise the question later. That goes to the essence of the case; if you don't succeed on that you are going to lose your case, aren't you?

Mr. Howard: My view of the case is if under the circumstances these executors employed and by training and background unable to discharge these responsibilities themselves, if they turned to a lawyer of fine reputation and long experience and entrusted that responsibility to him, and he in turn undertook to exercise that responsibility and did so in good faith, that under the laws, as I understand



(Testimony of Lloyd J. Cosgrove.)

it, reasonable cause is shown. The substance of the decision——

The Court: I really prefer that you don't argue this matter until we get the facts completed, because I don't want to make a snap judgment. At the moment it seems to me that this is a somewhat vital matter.

Mr. Gillard: If the Court please, I would like to direct [50] your attention to this, and I think, perhaps, the plaintiff has stated his position, I would like to point out to the Court, or to suggest it to the Court that the real issue in this case is the negligence or otherwise of the executor and executrix, and the question as to whether the attorney was competent or was negligent, or had reasonable cause to rely upon certain extraneous facts, and did things properly or improperly is not the question before the Court, and that no showing of completely proper action at all stages of the proceeding on the part of Mr. Cosgrove, if that were the situation, would have any bearing upon the question whether or not the executor, who is suing for the refund, who paid the penalty, and the only party in interest, would have no bearing upon the question of whether or not the executor was negligent or willfully negligent in the matter.

The Court: I'm not certain about that. The executor, of course, can act through an agent or a representative; it may be that the act of the agent or representative is the act of the executor. All that I think that we ought to do at the moment is to re-

(Testimony of Lloyd J. Cosgrove.)

serve the ruling so that we have the evidence in, if it not competent and material to the issues, it is there, and it can be stricken out, but it's there for the record so that either side may have it for what worth it has, either in affirmance of the claim or——

Mr. Gillard: (Interrupting) I suggest to the Court, if [51] we are going to try, in effect, if we are going to try Mr. Cosgrove, which is the direction the Court is now taking, I am going, perforce, I believe, have to ask for an extension of time, and the case is going to assume all the aspects of a criminal trial. Then the Court is going to be trying Mr. Cosgrove on the question of whether or not he acted properly in this case, not the Ferrandos, and that the witnesses will have to be numerous.

The Court: You may be right about that. The Ferrandos may be bound by the failure of the attorney not to file within the time specified.

Mr. Gillard: Has the Court read the claim? The theory of the claim and, of course, the complaint and cause of action is no different and can't go beyond that is: That these returns were not timely filed as required by law, but that the executors were not—that this late filing was not due to, as far as the executors are concerned it was due to reasonable cause and not to willful neglect, as far as the executors are concerned. That is the basis of the claim.

The Court: I understand your contention. Your contention is in order for the executors to support their claim for a refund they must show they have

(Testimony of Lloyd J. Cosgrove.)

reasonable grounds for the delay.

Mr. Gillard: That is correct.

The Court: Untimeliness of the claim. I think that, of [52] course, is the issue, but I didn't intend we were going to get into the phase of the matter that you suggested.

Mr. Gillard: I think it is unavoidable.

The Court: I don't think it is material.

Mr. Gillard: It is unavoidable.

The Court: But the answer of the witness does give the basis upon which the witness acted, and you are not intending to pursue that any further, are you?

Mr. Howard: No, I am not.

The Court: I will reserve ruling on the motion to strike this.

Mr. Howard: I just wanted to ask one additional question which I think is material, and is this: May I ask the question, proceed to ask it?

Q. (By Mr. Howard): Mr. Cosgrove, did Mr. Ferrando and his mother, Mrs. Ferrando, have any knowledge of your conversations or your relationship with the Collector of Internal Revenue with regard to the filing of this return?

Mr. Gillard: I will object to that as calling for an opinion and conclusion of the witness.

The Court: Yes, you can ask whether he ever told him, to avoid that part of it.

The Witness: I never told him.

Q. (By Mr. Howard): Did you ever communicate to Mr. Ferrando or his mother any of your

(Testimony of Lloyd J. Cosgrove.)

conversations with the office of the [53] Collector of Internal Revenue with regard to the filing of the return?      A. I did not.

Q. Did you ever advise Mr. Ferrando or his mother that the law required the filing of the return within fifteen months?

A. I don't believe so.

Q. Did you ever advise Mr. Ferrando or his mother that you had obtained an extension of time to file the return?      A. I don't believe so.

Mr. Howard: I have no further questions.

The Court: Would you prefer this matter be continued after the noon recess?

Mr. Gillard: It is getting a little long.

The Court: We will recess and resume at 2 o'clock, then.

(Whereupon at 12 Noon a recess was taken.)

Thursday, March 15, 1956—2:00 p.m.

Mr. Gillard: Had you finished your examination?

Mr. Howard: I just wanted to ask the witness one question.

Q. (By Mr. Howard): Mr. Cosgrove, how long had you known Mr. Ferrando, prior to the time of his father's death?

A. Oh, I'd say for a period of, say, fifteen to twenty years.

Q. Had you had any professional relations with him during that time?

A. With him and his family, yes.

(Testimony of Lloyd J. Cosgrove.)

Q. You represented them in various legal matters?

A. I would say for a period of fifteen to twenty years I represented Fred Ferrando of Ferrando and Company, yes.

Mr. Howard: I have no further questions.

### Cross Examination

Q. (By Mr. Gillard): Mr. Cosgrove, you were in the courtroom this morning, were you, when Mr. Ferrando, Mr. Fred Ferrando was testifying?

A. Yes, that is right, sir. I might say I wasn't here when he commenced to testify, but I arrived around, oh, a quarter to eleven, eleven o'clock, sir.

Q. Were you here during that period of time when he was testifying with reference to an indemnity agreement with you with reference to this? [55]

A. I heard him testify on that subject.

Q. Is that correct, sir, that you had agreed to indemnify him in the event that he is not successful in this action?

Mr. Howard: We make the same objection to that question, your Honor, that I did in the case of Mr. Ferrando.

Mr. Gillard: This goes directly to bias and interest.

The Court: Overruled.

A. I would like to answer that without a yes or no at this time, if you don't mind.

When I was in difficulty and Mr. Ferrando was



(Testimony of Lloyd J. Cosgrove.)

called upon for a penalty in this tax, I told him that he would not suffer a loss as far as I am concerned. Subsequently I gave him a letter—Mr. Alioto, who represented me, gave him a letter to the extent that we would reimburse—that I would reimburse him in the event he suffered a loss as far as that penalty was concerned. It was not conditional or contingent upon him filing the suit, or it wasn't subject to him obtaining any money back from the penalties he paid.

I felt that I undertook to do a job; if by virtue of my conduct there was penalty imposed upon him, I told him I would—he would not suffer a loss, and I confirmed that in a letter.

Q. And you confirmed the letter from Mr. Alioto to Mr. Ferrando?

A. That is correct. [56]

Q. So as the matter now stands, Mr. Cosgrove, what is the extent of your guaranty to Mr. Ferrando and Mrs. Ferrando?

A. I think that is something I don't think the Court will have to interpret, because I don't think it will ever go that far. But I recognize a moral obligation there; whether or not it is legal it is immaterial to me, it is an obligation on my part. If he suffers any loss I am willing to see he is reimbursed by me.

Q. You are aware of the fact that as the matter now stands Mr. Ferrando has paid in penalty and interest on that penalty the sum of \$4,706, are you not?

A. I realize that, sir; yes.



(Testimony of Lloyd J. Cosgrove.)

Q. That is the extent of his loss as of this minute, is that correct, plus interest on that amount since it was paid in early '52.

A. I recognize that he paid certain monies, sir, and my statement to him has been, and I think covered by that letter, that I indemnify. No mention has been made about interest at all, sir, and I don't recognize any interest; but I recognize that, the money he paid out.

Q. The loss, if he suffers a loss, it will only be as a result of not being successful in this action, is that not true, Mr. Cosgrove?

A. I would say so.

Q. So that you have a financial interest in this litigation [57] to the extent of \$4,700, is that correct?

A. That is a matter of opinion; I don't know how to answer that.

Q. You wouldn't reach that conclusion?

A. No, I wouldn't reach that conclusion, sir.

Q. What conclusion would you reach, sir?

A. I recognize a moral obligation to him, sir, if he suffers any loss at all I am willing to stand behind my statement to reimburse him. Whether I have a financial interest in this case is something his Honor might determine, but I can't determine that.

Q. Mr. Cosgrove, prior to the time that the Ferrandos came to you in this matter, did you consider yourself to be an expert in or specializing in Federal estate tax returns?

(Testimony of Lloyd J. Cosgrove.)

A. No, I didn't, never considered myself a specialist. I considered myself just the average attorney. I had a neighborhood practice, still have a neighborhood practice. I do considerable amount of probate work. I don't say that in a bragging manner, sir, but I do say this: That we have kept rather busy in the practice of the law, but I consider myself only an average attorney.

Q. There is in the profession a certain group of attorneys who do specialize in tax matters, is that correct?

A. Are you referring to Federal estate taxes?

Q. No, Federal taxes. [58]

A. Well, I guess there are groups of men who specialize in various fields; I do know some that specialize in income tax work, some who specialize in personal injury work, some who specialize in collection work, if that is what you mean.

Q. Well, at that time——

A. I know of no one who specializes in Federal estate as a specialist.

Q. Did you consider yourself to be expert in the field of Federal estate tax returns?

The Court: He has already answered that, Mr. Gillard.

Mr. Gillard: Did he?

The Court: He said no.

Q. (By Mr. Gillard): Did you represent to the Ferrandos that you were a specialist in Federal estate tax returns?

A. No, sir, I couldn't represent that to anybody.

(Testimony of Lloyd J. Cosgrove.)

Q. Did they ask you if you were a specialist in handling those matters?

A. I don't think so, no. I wouldn't know, but my answer would be no.

Q. As a matter of fact, during this period of time and prior to the time the Ferrandos came to you, and subsequent to that time for complicated estate taxes that came into your office you referred those out to other people for the preparation of the returns, did you not, Mr. Cosgrove?

A. That is correct, sir; and "other people" would be a [59] certified public accountant.

Q. Now, sir, you testified towards the close of your direct examination with respect to a verbal agreement you had with Mr. Doyle with reference to an extension of time to file this return, you referred to that as in the nature of a stipulation with another attorney? A. That is right, sir.

Q. In any other of the Federal estate tax returns that you had to file, did you have such agreements with Mr. Doyle?

A. I don't know; anyone in particular you have in mind, sir?

Q. No, I am asking you if you recall you did that on other occasions with Mr. Doyle?

A. Right now I can't recall it.

Q. Were there any situations you can recall you did not do that with Mr. Doyle?

A. Oh, many estate returns have been filed.

Q. But you did not do that?

A. Well, I did not request it of anybody.

(Testimony of Lloyd J. Cosgrove.)

Q. Were there any situations in which you got an extension of time in any other manner than by this verbal agreement with Mr. Doyle?

A. Yes, I did.

Q. And what estate was that?

A. Estate of Ferrari, sir.

Q. In the estate of Ferrari you secured a written extension [60] of time from the office of the Collector of Internal Revenue, did you not?

A. That is correct.

Q. That was for a period of thirty days?

A. That's right.

Q. That was pursuant to the regulations that you referred to this morning, is that correct?

A. I wasn't referring to this matter this morning.

Q. Well, this morning when you testified you were asked if you were familiar with the time when returns were required to be filed and extensions thereof, and you said that you were familiar with what the regulations provided, is that correct?

A. I don't recall the question being directed to me in that language. I do recall the statement—question being asked of me, and I stated I knew the regulations asked that the returns be filed within a fifteen month period. I don't know if there was an extension included in that or not.

The Court: I think what Mr. Gillard refers to is some part of your answer in which you said that instead of filing affidavits and other documents nec-

(Testimony of Lloyd J. Cosgrove.)

essary for the extension you had a verbal understanding.

The Witness: That's right.

The Court: In the Ferrando case with the man in the Collector's office.

The Witness: That's right, sir. [61]

The Court: I think that is what you are referring to.

Mr. Gillard: Yes.

Q. (By Mr. Gillard): Mr. Cosgrove, at that time—now referring to 1947, '48, '49—were you familiar with the regulations with reference to the filing of estate tax returns and securing extensions on the filing date provided?

A. I would say as an average attorney I was.

Q. And what is your recollection as to what that knowledge was at that time?

A. My recollection is that that return should be filed within the fifteen months after date of death, or fifteen months after the appointment of an executor or administrator, if one is appointed within the sixty day period of time. I know there is some provision along that line.

I further know this: That extensions can be granted. I further know it was the common practice prevailing at that time.

Q. I am asking you about the regulations now, sir.

A. And the regulations provided an extension could be granted.

Q. For what period of time?



(Testimony of Lloyd J. Cosgrove.)

A. I am not familiar with that.

Q. Not familiar with the period of time for which an extension could be granted?

A. Right now I can't recall it.

Q. Would your action in the Ferrari estate indicate to you what [62] the period of time was?

A. No. I think I only asked for thirty days extension, and that is what I received.

Q. Wasn't that the period of time allowed for by the regulations, Mr. Cosgrove?

A. I don't think so, I think you could get additional time by filing an affidavit.

Q. Now, then, was it your understanding that from the Collector, that is the local Collector in the office of the Internal Revenue, you could secure a thirty day extension of time, is that correct?

A. I didn't know it was confined to the Collector, all I know is this: That what we had to do was to make application, and we received back in the mail the thirty day extension of time, and I received that in the Ferrari case; I asked for it and I got it. Now, what their powers were at that time I didn't know, any further than I was under the impression or belief you could get a further extension of time.

Q. In connection with these two estates, Ferrando and Ferrari, you knew from the time of the due date of the return that extensions would be required, did you not?

A. May I have that question again, please?



(Testimony of Lloyd J. Cosgrove.)

The Court: You mean it would be necessary for him to have an extension?

Mr. Gillard: Yes. [63]

A. Yes.

Q. (By Mr. Gillard): Upon the due date—let's take the Ferrando return, we are talking about that in this case first, upon the due date of that return, and by the way, was that return due on July 20, 1948? A. I couldn't recall.

Q. Do you recall the date of death of Mr. Ferrando, Mr. Cosgrove?

A. No, I do not recall. That's—it's right there in the files there, though.

Q. Well, if I were to tell you that the testimony has shown so far that the date of death in that case was April 20, 1947, and that the executors were not appointed within the sixty day provision you referred to, would you say that the return was due fifteen months after April 20, 1947?

A. I would say so.

Q. When was it that you went to see or you telephoned Mr. Doyle with reference to this verbal extension you testified about?

A. I would say within a very short time of fifteen months after the date of death.

Q. Your recollection is that it was after the extension period had expired? A. No, sir.

Q. It was prior to the time the fifteen months had expired? [64]

A. It was prior to the expiration of the fifteen month period of time, sir.

(Testimony of Lloyd J. Cosgrove.)

Q. For the purpose of determining in what fashion you should proceed to secure that extension, did you consult the regulations of the Treasury Department?

A. No, sir, I relied on the telephone, sir.

Q. You relied on the telephone. You did not acquaint yourself with either the statutes or the regulations in connection with that subject, is that correct?

A. I was familiar with what the regulations stated.

Q. Now, that is what I asked a little while ago, Mr. Cosgrove, what did those regulations state about that?

A. That the return should be filed within fifteen months after date of death.

Q. I am asking you about the extensions now, sir.

A. We are a little confused here now. The regulations—I was familiar with the regulations to the extent that I knew that the return should be filed within the fifteen month period of time, sir. Now, will you direct the next question?

Q. My next question to you, sir, then is: At the time that you went to Mr. Doyle, just shortly before the expiration of that fifteen months, did you, for the purpose of securing an extension, acquaint yourself with what the regulations said about how to secure an extension and for what time you could secure an extension? [65]

A. I made no independent investigation, sir,

(Testimony of Lloyd J. Cosgrove.)

other than to communicate with Mr. Doyle, who was number two man in the Internal Revenue Department in San Francisco. I explained to him my situation, I told him I didn't think—I couldn't get the return out on time, and I asked for more time and he granted me more time, which I thought he had the authority to do.

Q. Did you ask anybody what the regulations provided with reference to an extension?

A. I asked nobody other than that one gentleman.

Q. Isn't it a fact, Mr. Cosgrove, that at that time, as you indicated a little earlier in your testimony, that you knew that the extension that could be granted by the local office was thirty days?

A. I wouldn't say that, sir.

Q. Did you have any indication at all that there was any limitation of time imposed by the regulations on the power of the local collector to grant an extension of time to file an estate tax return?

A. At that time I don't believe I did.

Q. You mentioned the fact that there was also the possibility of securing an additional length of time by filing affidavits, is that correct?

A. That was my understanding.

Q. What was your understanding about that additional length of time, and the filing of affidavits? [66]

A. I don't want to be construed as using the word "additional." I knew the method of getting extensions of time, as far as filing the Federal es-

(Testimony of Lloyd J. Cosgrove.)

tate tax return, was to file an affidavit explaining the reason why you can't get it in on time and you can get an additional time.

Q. Did you do that, sir, in the Ferrando case?

A. No, sir, I did not.

Q. Did you do it in the Ferrari case?

A. No, sir, I did not.

Q. When did you seek the extension of time in the Ferrari case?

A. Within a few days prior to the expiration of fifteen months after the date of death.

Q. And how did you make application for that extension?

A. I really don't recall, not right now, I don't know whether I went down and asked, used a telephone and one was mailed to me, I really don't recall now.

Q. Did you file a written application for an extension?

A. I have no recollection on how that was obtained, sir.

Q. Do you know who you went to to get that extension?

A. Gee, right now I wouldn't know; I don't know.

Q. Did you go to Mr. Doyle?

A. I couldn't tell you, I don't know. There was one time I went to Mr. Smythe, he wasn't in, and I was directed to Mr. Doyle. One other time, I think in one case, I just telephoned down there, [67] or

(Testimony of Lloyd J. Cosgrove.)

went down there in the Estate Tax Division and got an extension, but I am not clear on that one.

Q. An extension was granted to you in that case, wasn't it, Mr. Cosgrove, in writing?

A. I received one in writing a day or two after I asked for it, I think.

Q. Within a day or two after you asked for it?

A. Yes.

Mr. Gillard: I am going to ask to have marked for identification in this case the second sheet in the photostatic copy of the return in the estate of Luigi Ferrari, that second sheet being a letter with reference to an extension of time secured in that estate.

The Clerk: That will be Defendant's Exhibit A in the Ferrari case.

Mr. Gillard: No, in this case.

The Clerk: Then that will be Defendant's Exhibit E marked for identification in the Ferrando case.

(Whereupon second sheet of letter received and marked Defendant's Exhibit E for identification only.)

Q. (By Mr. Gillard): I show you, Mr. Cosgrove, Exhibit E, and ask you if that is the document you referred to as having received in response to your request for an extension in the Ferrari case?

A. Yes, sir, that is the letter I received. [68]

Q. Thank you, sir.



(Testimony of Lloyd J. Cosgrove.)

Mr. Gillard: I will offer Exhibit E for identification into evidence.

The Court: Admitted.

(Whereupon Defendant's Exhibit E heretofore marked for identification only was received and marked in evidence.)

Q. (By Mr. Gillard): Now, Mr. Cosgrove,——

The Court: What does that say? Mind telling me about it now?

Mr. Gillard: Shall I read it to you, read it into the record?

The Court: I will read it. Go right ahead.

Q. (By Mr. Gillard): Mr. Cosgrove, was it your understanding in July of 1947 that under the regulations an indefinite extension of time could be secured to file an estate tax return?

A. Referring now to July of what year, sir?

Q. 1947.

A. I don't think I had any opinion on it at that time, sir. I say I don't think I had any opinion on it.

Q. Did you attempt to advise yourself at any time after securing this agreement you referred to with Mr. Doyle, as to the length of time that extension would run?

A. After I received this extension, as I believed it, from Mr. Doyle, I understood Mr. Doyle to be a man of executive [69] ability in an executive position with the Internal Revenue Department and in a position to give me what I asked for, and when he told me to bring it in when I got around to it, or



(Testimony of Lloyd J. Cosgrove.)

when I got it prepared, I understood, I believed him to have the authority to do it, and I further believed at that time that it was the common practice.

Q. You understood that to be an open extension allowing you to file that return at any time that you got around to doing it?

A. That is about right, sir.

Q. That would be regardless of whether it took you five years or ten years?

A. Well, we are dealing with reasonable limitations here, now.

Q. There was a limitation on it, Mr. Cosgrove?

A. I say reasonable limitation.

Q. There was a reasonable limitation on it?

A. No, but I say, construed, not going to have an unlimited extension of time, that will bring you beyond the reasonable length of time anyway.

Q. If it wasn't unlimited, Mr. Cosgrove, what was the limit?

A. There was no limit stated on it.

Q. There was no limit at all?

A. But you are not going to take advantage of an extension of time and not do it within a reasonable length of time.

Q. I gather from your testimony that you considered that Mr. Doyle, unlike any other employee in the Internal Revenue Service, [70] was not bound by the regulations of the Treasury Department applying to that service?

A. I didn't say that, sir.

The Court: Well, that's rather argumentative.

(Testimony of Lloyd J. Cosgrove.)

Q. (By Mr. Gillard): Now, sir, to whom did you refer the Ferrari matters for the preparation of an estate tax return?

A. I asked the office of Prior & McClellan to prepare the Federal estate returns in this matter after I forwarded all the information I thought he may need for the preparation of it.

Q. Prior & McClellan are certified public accountants?

A. Yes. In the Ferrari matter I prepared the first one.

Q. No, I am just talking about the Ferrando case now.

A. Ferrando.

Q. You know when you referred this matter to Prior & McClellan?

A. No, I couldn't say that, but in the record I think there are a lot of letters here as to the day it was forwarded to them.

Q. Let's see, this agreement you had with Mr. Doyle was some time in July of 1947, is that correct?

A. What was the date of death, if you have that information?

Q. The date of death was April 20, 1947—I beg your pardon, in July of 1948.

A. That is about right, sir.

Q. I was confused on those dates myself, Mr. Cosgrove. I beg your pardon. Referring you back to Exhibit E for identification in the Ferrari estate, you received a thirty day extension of [71] time by letter dated October 1, 1947, is that correct?

(Testimony of Lloyd J. Cosgrove.)

A. Is that the date of that exhibit?

Q. That is the date of that exhibit, sir, October 31, 1947, and that was that extension of time which was issued to you by Martin J. Tierney, Chief, Miscellaneous Tax Division; is that correct, sir?

A. He signed the letter, sir. I don't know if I asked him or not, but the letter is mailed to me bearing that signature.

Q. And then the following July, that is July 1948, you went to Mr. Doyle for an extension in the Ferrando estate?      A. I think that's correct.

Mr. Gillard: I will ask you to mark this.

The Clerk: Defendant's Exhibit F marked for identification; Defendant's Exhibit G marked for identification; Defendant's Exhibit H marked for identification; Defendant's Exhibit I marked for identification; Defendant's Exhibit J marked for identification.

(Whereupon letter dated November 10, 1948 received and marked Defendant's Exhibit F for identification only; letter to Mr. Cosgrove dated November 19, 1948 received and marked Defendant's Exhibit G for identification only; letter dated January 12, 1949 to Prior & McClellan received and marked Defendant's Exhibit H for identification only; letter dated January 24, 1949 to Prior & McClellan received and marked Defendant's Exhibit I for identification only; [72] letter dated February 7, 1949 to Mr. Cosgrove received and marked Defendant's Exhibit J for identification only.)

(Testimony of Lloyd J. Cosgrove.)

Q. (By Mr. Gillard): Mr. Cosgrove, I will show you five photostatic copies of letters. These are the same letters as were shown to you and identified in the criminal trial, marked exhibits F, G, H, I, and J, pertaining to correspondence that you had with the office of Prior & McClellan, and ask you, sir, if you will identify those as the correspondence you had at the end of 1948 and the first part of 1949 with the accountants you had employed to file the returns in this estate?

The Court: Ferrando estate?

Mr. Gillard: In the Ferrando estate.

The Court: I would like to orient myself on this, Mr. Gillard. Ferrari died in 1946 and Ferrando in 1948; isn't that right?

Mr. Gillard: Ferrari, Luigi Ferrari died August 2, 1946.

The Court: And Ferrando died in April, 1947?

Mr. Gillard: That is correct, your Honor.

The Court: There was that lapse of time in between the two.

Mr. Gillard: That is correct.

The Court: Thus the time for filing the estate tax was that much difference, relatively speaking?

Mr. Gillard: That is correct.

A. I recognize this correspondence, sir. [73]

Q. (By Mr. Gillard): And that is the correspondence you had with that firm of Prior & McClellan, and their correspondence back to you, with reference to the preparation of this return and the Ferrando estate; is that correct, sir?

(Testimony of Lloyd J. Cosgrove.)

A. That is correct, sir.

Mr. Gillard: I will offer those in evidence, if the Court please, to bear the same numbers.

The Court: Very well, admitted.

(Whereupon correspondence between Mr. Cosgrove and firm of Prior & McClellan end of 1948 and first part of 1949 received and marked Defendant's Exhibits F, G, H, I, and J in evidence.)

Q. (By Mr. Gillard): Mr. Cosgrove, you will note, sir, you did note that the last letter in that series was dated February 7, 1949—that was Exhibit I—from Prior & McClellan to you enclosing original and three copies of the tax returns which they prepared in the Ferrando estate, is that correct? A. That is correct, sir.

Q. And then the following day, on February 8, you wrote, (handing the witness Exhibit 1), you wrote a letter to the Ferrandos advising them you had the returns and requested them to come in and sign them, is that correct?

A. That is correct.

Q. You recall when they came into your office to sign those returns? [74]

A. I have no independent recollection of the time. I'd say they came in shortly after that, the date of that letter.

Q. At the time that they came in to sign their returns, did they at the same time, or did Fred Ferrando at the same time make out his check for the payment of the amount of tax that was due?



(Testimony of Lloyd J. Cosgrove.)

A. I don't believe so.

Q. Did he make out that check after he had been in your office to sign the returns?

A. I would say he did.

Q. So that the best of your recollection is that these returns, or this return, rather, was signed in your office sometime between February 8, the date of this letter to Mr. Fred Ferrando, and February 17, the date he wrote that check, is that correct?

A. I would say that the returns were signed in my office approximately a few days after the date of that letter, sir. Now, when that check was written out, I don't know.

Q. Now, sir, after the date that Mr. Ferrando and his mother came to your office to sign this return, you considered that you were still operating under an extension of time granted by Mr. Doyle to file these returns, is that correct?

A. That is right, sir.

Q. And pursuant to that thought on your part you considered that the return was being returned timely pursuant to that extension Mr. Doyle had granted you, is that correct? [75]

A. That is correct.

Q. So that pursuant to that understanding on your part this return could have been dated at the date it was signed by Mr. and Mrs. Ferrando, could it not, and still have been timely filed, according to your understanding?

A. Quite often you secure an extension of time and you date it the day of the extension being



(Testimony of Lloyd J. Cosgrove.)

granted. It is the same way as the Court making an order, a decree is entered in court, and many judges will sign the decree, although it may be presented later, they will sign it the day the order is made. That is the practice in probate in San Francisco.

Q. It was your thought, then, was it, that an extension of time forward to do a certain in the future would be dated not when the act was done in the future pursuant to that stipulation, but rather at the time the original agreement was granted?

A. I had no thought on the subject at the time, so I wouldn't answer, wouldn't attempt to answer that question in that fashion, but I do say this: That in practice a decree is often made in probate court, and I think it is a common practice, the Court decree is made in probate court today and the judge, some of the judges, will sign the order even though it may be presented a week or two weeks later, would be signed the day that the order was made.

Q. You're talking about an act which was done on a certain day, is that correct, to-wit, the granting of the order? [76]

A. That's right.

Q. Now, in this situation, Mr. Cosgrove, isn't it true that the act was done in July of 1947, which was merely the granting of an extension of time; that was the order at that time, wasn't it?

A. That's right, it was a verbal extension of time.

Q. Was it your understanding that when the Ferrandos came into your office in February of

(Testimony of Lloyd J. Cosgrove.)

1949 that they were signing a timely Federal estate tax return?       A. That was right, sir.

Q. That is right. Then why, sir, did you not put that date down, that timely date?

A. Why, that is something that we can not answer, why this was done or why the next thing was done. All that we can say is this: That as we look back it probably would have been simpler to do it, to put down the day it was signed. That is probably what should have been done. But it was signed that way, and the thought might have been at the time to make it retroactive to the date the extension was granted.

Now, other than that I have no explanation to make, and other than that the thought did not enter my mind at the time.

Q. Now, sir, was the date July 15, 1948, typed on the return before Mr. and Mrs. Ferrando signed it?

A. I couldn't tell you. If I see that return I might—— [77]

Q. I will show you the original of it, sir.

A. Might refresh my memory. You have reference to the date?

Q. Yes, sir.

A. I couldn't tell you when the date was typed in there, sir.

Q. Now, at the time you received these returns from Mr. McClellan with his letter of February 7, 1949—that's Exhibit J—Mr. McClellan had signed

(Testimony of Lloyd J. Cosgrove.)

his name but put no date on the return, is that correct?

A. I wouldn't know, but it looks to me to be the same typing at the time it was—same typing opposite the signatures of the executor and executrix as the typing before or alongside his name, but I have no recollection or independent knowledge as to when it was signed or whether it was dated at that time.

Q. You were aware, I assume, that return was prepared by Mr. McClellan on February 7, 1949, is that correct?

A. Mr. McClellan's office prepared returns for me sometime in between those dates, or around those dates that's indicated on those letters, sir.

Q. Would you say that according to Exhibit I that that was the date upon which the return was prepared by Mr. McClellan?

A. You are only asking me for an opinion and conclusion.

The Court: Is that important? Sent the return to him with a letter of February 7, 1949.

Mr. Gillard: I will revise the question, if the Court please. [78]

Q. (By Mr. Gillard): Mr. Cosgrove, at whose direction was the—were the words and figures "15th July 1948" typed opposite the signature of Mr. McClellan and above the notarial signature of Ruth Cosgrove?

A. I have no recollection as to who asked that to be done or when it was done, sir. All I can say is

(Testimony of Lloyd J. Cosgrove.)

this: That it appears to me it was done in my office. It was a partnership of Mr. Molinari, Mr. Tinney and myself that composed the office at that time. We assumed the responsibility of the preparation of this return and I say that it was done in our office.

Q. Ruth Cosgrove is your sister, sir?

A. Ruth Cosgrove is my sister; she acknowledged this instrument at my request.

Q. And did she acknowledge it by putting in that date, July 15, 1948, at your request?

A. No, I have no recollection on that, and further, that her writing, she signed this in her own handwriting, and wrote other matters on there, and the date is typed, so I don't think she had anything to do with that date.

Q. So my question was: Did she sign that thing pursuant to your direction in February of 1949?

A. I have no independent recollection as to when she signed it.

Q. Mr. McClellan appear before her?

A. I don't know, I couldn't answer that, but I would say he [79] didn't. I wasn't—I have no recollection on it but I assume he didn't appear before her.

Q. You would assume, I gather, from what you say, that you are responsible for the insertion of the date July 15, 1948, on this Exhibit C, is that correct? A. No, I didn't say that.

Q. What did you say, Mr. Cosgrove?

A. I said my office was responsible for that be-

(Testimony of Lloyd J. Cosgrove.)

cause we undertook to do this work. As to when that date was put on there, as to who put it on there, I have no recollection and I have no knowledge of it.

Q. Do you know whether or not, sir, that that constitutes a change, that date, July 15, 1948, opposite the signature of A. A. McClellan, constitutes a change in the return that was sent to you by Mr. McClellan with his letter of February 7, 1949?

A. Do I know that?

Q. Yes, sir.                      A. No, I do not.

Mr. Gillard: Will you mark this?

The Clerk: Defendant's Exhibit K marked for identification.

(Whereupon estate tax return for decedent Mario Ferrando received and marked Defendant's Exhibit K for identification only.)

Mr. Gillard: I show you, Mr. Cosgrove, Exhibit K for [80] identification. This was Exhibit 30 in your last trial, criminal trial, and ask you, sir, if that was one of the copies of the Ferrando return that was mailed to you by Mr. McClellan with his letter of February 7, 1949—a photostat of one of the copies that he sent you?

A. I couldn't answer that, sir.

Q. You couldn't answer that, sir?

A. No, I don't know, I have no recollection of remembering what was sent to, what the returns were in 1949 that I received.

The Court: Can you demonstrate by comparison that it is a copy? I mean, is there any need to—



(Testimony of Lloyd J. Cosgrove.)

Mr. Howard: Looks like a working paper; it is in longhand. I don't believe it is a copy of anything that is in the record.

The Witness: I would——

Q. (By Mr. Gillard): Did you see that document at the criminal trial, Mr. Cosgrove?

A. I saw everything at the criminal trial, and I saw more than was presented to me.

Q. You notice it is stamped Exhibit 30. Do you recall seeing that at the criminal trial?

A. I don't recall seeing it, but evidently it was used in the other hearing.

Q. That document which, on the signature page, bears the signature of Mr. McClellan, does it not, sir? [81]

A. It bears a writing of A. A. McClellan. Whether or not he signed it, I wouldn't know.

Q. Will you check and compare that with the Exhibit C in front of you, sir, the original of the estate tax return?

A. To me it looks identical.

Q. Is it your testimony that you never saw that last Exhibit K, you never saw that Exhibit K?

A. That is not my testimony, no.

Q. You don't recall having seen it before?

A. If it was used in the criminal case I evidently saw it, but I have no recollection now that it was presented to me at that time.

Q. Is it your testimony, sir, that the documents, the estate tax returns that were forwarded to you

(Testimony of Lloyd J. Cosgrove.)

by Mr. McClellan were not dated at the time that they were received by you?

A. That isn't my contention.

Q. What is your testimony, sir?

A. Well, I don't want to get into an argument with you. What is your question?

Q. The question is: Was the return which you received, the returns that you received with the letter of February 7, 1949, from Mr. McClellan, were those returns signed and dated by Mr. McClellan?

A. That I couldn't tell you.

Q. They could have been signed and dated?

A. From looking at this, and just casually looking at this exhibit, I would say since it is represented here that this is Mr. McClellan's signature, I say it was signed by him, but it doesn't look like it was dated other than by the typewriter, 15 July, 1948. Now, when that date was put on there I don't know, and I don't know who did it.

Q. You recall whether or not the date February 7, 1949, was erased from that return?

A. I know it wasn't erased, because this paper doesn't indicate any erasure on it.

Q. Now, sir, are you familiar with Treasury form No. 704? That is preliminary notice of estate tax?

A. Have you got a copy there?

Q. I don't have it in the Ferrando case, no.

A. I am not familiar with the form by number, sir.

Q. I will show you, sir, an estate tax preliminary notice, Treasury form 704, which was used in

(Testimony of Lloyd J. Cosgrove.)

the Ferrari estate, and ask you if that refreshes your recollection as to a preliminary notice?

A. Yes, I recognize it now, not by the number, but by the wording of it.

Q. You filed one of those in the Ferrari case, is that correct, sir?

A. It appears that way, sir.

Q. Do you have any recollection whether you filed one in the [83] Ferrando case?

A. I don't think I did. I was told it was not necessary. They never ask for this any more, or didn't ask for it at that time.

Q. You mean after this one was filed they didn't want any more?

A. At this time they didn't want—I shouldn't say they didn't want it, they said it wasn't necessary.

Q. They said it wasn't necessary?

A. That is right.

Q. What is the date of that, sir?

A. There is a couple of stamp marks here; one is December 1, another one is January 21, 1948 and there is another one in January something, 1948. There's about three stamp filed—not filed, but stamp marks on it.

Q. Stamp marks starting in December of 1947?

A. December 1 of—I can't make out the year, sir. Other than that I don't see any date on the paper.

Q. Do you recall, sir, when, under the regula-

(Testimony of Lloyd J. Cosgrove.)

tions, a preliminary notice was supposed to be filed with reference to the date of death?

A. I believe the regulations ask for it to be filed within ninety days, but they say it is not necessary.

Q. Within ninety days after the date of death?

A. But the department up there say it is not necessary to [84] file it.

Q. And this is dated December 1, 1947, stamped as received?

A. I could be wrong on that ninety days, either ninety days or six months.

Q. If you will check the instructions on the reverse side of the form—will you check those instructions on the reverse side of the form and advise me if that is your recollection as to the two month period is your recollection as to the correct time to file a preliminary notice?

A. Is there any particular part of this that you want me to direct my attention to? It is quite lengthy.

Q. There is a little paragraph in there with reference to the time of filing, Mr. Cosgrove. I have my finger opposite it.

A. The instructions on the back of this page says two months after the death.

Q. And if I understand you correctly, the first time that you knew that this form was not required to be filed was when this form in the Ferrari estate was taken down to be filed, is that correct?

A. No, sir, you are wrong.

Q. What was your testimony, sir?

(Testimony of Lloyd J. Cosgrove.)

A. The testimony is that they tell me up in the Collector's office, for a long time told me that it was not necessary to be filed, they do not require it.

Q. You mean they told you that before you filed the estate [85] tax notice in the Ferrari case, the one in front of you?

A. Long before this here notice was ever filed in the Collector's Office they told me this form was not required by them and it's not necessary to be filed.

Q. Long before you took that one down there?

A. Yes, and they tell you that today, too.

Q. Was this the only, of the three estates that were involved in this period of time, the Ferrando, the Ferrari and the Fontana estates, was this the only one in which, the Ferrari, the only one in which you filed that form?

A. What three are you talking about?

Q. Ferrari, Fontana and Ferrando.

A. Fontana has nothing to do with this case.

Q. I am merely asking you that as a question, Mr. Cosgrove. Answer it, please.

A. I couldn't tell you what procedure happened in the other ones, but I can explain this one, if you desire. This, I think, you will find was filed just about the same period of time that the extension was granted. I am reasonably sure you will find that, and if my recollections are correct at the time the request was made for that thirty days extension the preliminary notice was asked to be filed about that same time, and that is the only one that was ever asked.

Q. Now, I will show you Exhibit E, sir, which,



(Testimony of Lloyd J. Cosgrove.)

on October 31, 1947, a month prior to this date, you had already received [86] your thirty day extension of time in the Ferrari case.

A. That is right.

Q. Now, sir, can you tell me why you filed that form 704 in the Ferrari case?

A. Because, as I say after the period of time, around that period of time when this extension was asked and received, the extension, the request then was also made that this form be filled out.

Q. Request was then made? A. Yes.

Q. Did I misunderstand you to tell me they had advised you consistently a long time prior to this that they did not want this form?

A. That is correct, and on this form, evidently when I asked for the extension of time, they gave me the extension of time, they did ask that this preliminary be filled out and filed with them. And as you will notice here the date is, of the extension, was granted to November 2 and this is filed about the first of December.

Q. So then at the time you got the extension of time in the Ferrando case from Mr. Doyle, was a request made of you at that time?

A. No, sir.

Q. That you file a Form 704 in the Ferrando case? A. No, sir. [87]

Q. Mr. Cosgrove, going back to your testimony of a while ago about that date, in the trial of the criminal action, I believe that was 33,214, in the second trial, the transcript at page 831, Exhibit 6—

(Testimony of Lloyd J. Cosgrove.)

I don't believe I have Exhibit 6. Pardon me, your Honor, for just a moment.

Withdraw that question. Exhibit 6 I can't identify at this point.

I have no further questions, your Honor.

### Redirect Examination

Q. (By Mr. Howard): Mr. Cosgrove, with reference to the Ferrando estate, at the time Mr. Ferrando and his mother came to you you testified on cross-examination that you did not represent to them that you were an authority on Federal estate tax matters, is that correct?

A. That's correct.

Q. You did tell them at that time, however, that you would do everything required in the course of the probate of that estate, is that correct?

A. I told them I would be happy to handle the administration of the estate for them and that I would do everything required by law to complete the administration, the probate of the will and we would carry it out to completion.

Q. Now, at that time, or in connection with that estate, and also the Ferrari estate, you turned to Messrs. Prior & McClellan for assistance in preparation of those returns? [88]

A. Yes, in the Ferrando case they were in it at the start, and the Ferrari case, they were in the case, too, you might say.

Q. How long had you known Messrs. Prior & McClellan?

(Testimony of Lloyd J. Cosgrove.)

A. The office of Prior & McClellan have been doing tax work for me for ten or fifteen years.

Q. That included the preparation of Federal estate tax returns prior to this time?

A. That is right.

Q. Were they certified public accountants?

A. They are.

Mr. Howard: I have no further questions, your Honor, in connection with the Ferrando proceeding.

The Court: Well, would this then conclude the evidence with respect to the Ferrando case?

Mr. Gillard: Yes, your Honor, I have no evidence to introduce in the Ferrando case.

The Court: I beg pardon?

Mr. Gillard: I have no evidence to introduce in the Ferrando case.

The Court: Then we can conclude that. Now, you want to go on with the Ferrari case?

Mr. Howard: Yes.

The Court: How do you wish to proceed with that? You want to examine the attorney first or put the parties on?

Mr. Howard: Well, I think I can proceed with Mr. Cosgrove [89] at this time, your Honor.

The Court: Well, it is entirely up to you what you wish to do.

LLOYD J. COSGROVE

called as a witness by the plaintiffs, sworn.

Direct Examination

Q. (By Mr. Howard): Mr. Cosgrove, did you

(Testimony of Lloyd J. Cosgrove.)

know Luigi Ferrari prior to the time of his death?

A. I did.

Q. How long had you known him?

A. That, too, goes back about fifteen or twenty years, I would say.

Q. Had you had any professional relationship during that period of time? A. I did.

Q. Did you draw his last will and testament?

A. I believe I did.

Q. Now, at the time of Luigi Ferrari's death, or shortly after his death, did the plaintiffs in this action, George and Edward Ferrari consult you?

A. Yes, they did.

Q. And with reference to what?

A. As I recall it they brought a will in and asked me to take care of the probate of the estate for them.

Q. Did you undertake that employment? [90]

A. I did.

Q. Did you advise them at that time with respect to the obligations which you had undertaken to perform in that connection?

A. Well, I told them that I would carry out the work as an attorney for them in the administration of this estate.

I also advised them that we would call upon them at different times and various times to go to court and they would have to be prepared to sign papers for me as we went along.

Other than that I have no independent recollection of what I might have said to them.

(Testimony of Lloyd J. Cosgrove.)

Q. Did you request information from them from time to time in the course of that?

A. Oh, yes, as we went along we requested from them their appearances in the office to get information from them, and also for documents that they may have that would assist me in the administration of the estate. That went on for a period of time.

Q. Did you obtain from them the matters which you requested of them? A. I did.

Q. Now, Mr. Cosgrove, when did you first discuss the matter of Federal estate taxes, to the best of your recollection, with Mr.—Messrs. Ferrari?

Mr. Gillard: Object to that as assuming something not in evidence. [91]

The Court: You mean, if he did discuss them?

Mr. Howard: Well, let me ask the question this way:—

The Court: I don't quite get the objection.

Q. (By Mr. Howard): In the course of your representation of George and Edward Ferrari, did you discuss the Federal estate tax liability of the estate with them? A. I did.

Q. And when, to your recollection, did the first of those conversations take place?

A. Well, I have no independent recollection as to when they took place, but it is reasonable to assume that I did talk to them, if not at the first meeting, right after that. I am positive that I talked to them after I found out the properties, or I had a good knowledge of the properties that they had,



(Testimony of Lloyd J. Cosgrove.)

but after I secured from them the description of the various properties, parcels of property, I told them about the Federal estate tax that would be involved.

Q. Now, did you undertake and did you prepare a Federal estate tax return for the estate?

A. I did.

Q. Did you ask George and Edward Ferrari to sign a Federal estate tax return? A. I did.

Q. You recall when that occurred?

A. No, I have no independent recollection other than the fact [92] that it was signed by them prior to—signed the Federal estate returns prior to—if I may state, sixteen months after the death of the father.

Q. And where did that take place, Mr. Cosgrove? A. In my office.

Q. In your presence?

A. In my presence.

Q. And was that prior to the time the extension you referred to in your testimony in the Ferrando proceeding had expired, the written extension?

A. Well, in the Ferrari case I secured a written extension for a period of thirty days, and they signed the return, the Federal estate returns prior to the expiration of that thirty day time.

Q. Now, was that a completed return?

A. It wasn't a complete return, no. It could be construed as a complete return, but it wasn't an accurate return, if we could use that expression, because it was true all the properties were included in

(Testimony of Lloyd J. Cosgrove.)

the return, but we didn't have the inheritance tax appraisal on the properties.

So in most cases, in all cases it was just an estimate as to valuations and the liabilities, all the liabilities were not determined within that period of the sixteen months after date of death. So a lot of the liabilities were—I should *not a lot*, but some of the liabilities were eliminated from [93] the return, were not included in the return.

Q. Did you advise Messrs. Ferrari at that time of the extent of the Federal estate tax liability, or the approximate amount involved?

A. Advised the approximate amounts that would be involved, yes.

Q. Do you recall what that figure was?

A. Yes, the—I approximated the tax liability as around \$100,000, and I so advised them.

Q. Did you advise them with respect to the time and the manner of the payment of that liability?

A. Advised them that the tax liability would be around \$100,000 and that if it wasn't paid on date, have to pay interest on the money, I told them that.

Q. Did you explain to them that they would have to pay interest on that money?

A. Have to pay interest on the tax liability, yes.

Q. Now, what did you do with that return after it was signed by George and Edward Ferrari?

A. I delivered it to the office of the Internal Revenue in care of Mr. Doyle.

Q. Now, thereafter did you employ the services

(Testimony of Lloyd J. Cosgrove.)

of Messrs. Prior & McClellan in connection with that return?

A. I would say around that period of time I employed the services of Prior & McClellan, yes. [94]

Q. And at a later date did they furnish you with a completed return?

A. They did. The completed return—the completed return was prepared and I secured it from Prior & McClellan, after we received the report of the State Inheritance Tax Department from whom we got the valuations used on the Federal estate returns.

Q. I see. Now, in that return that was completed by Prior & McClellan, that was eventually filed with the Collector of Internal Revenue, is that correct?

A. Well, that return was sent to me, but analyzed by another attorney, and it was returned to me and then a return was filed with the Collector of Internal Revenue in substitution of the first one.

Q. Now, Mr. Cosgrove, the return that was filed at the Collector of Internal Revenue bears the signature of George and Edward Ferrari?

A. That is right.

Q. Now, do I understand that they signed that return, that their signatures were affixed to that piece of paper in your office in December of 1947?

A. Well, I don't want to be misunderstood. Mr. George and Edward Ferrari signed a Federal estate tax return in my office prior to the expiration of the sixteen month period of time. That return, in-

(Testimony of Lloyd J. Cosgrove.)

complete as it was, was left with the office of [95] Collector of Internal Revenue, and thereafter another return was prepared by Prior & McClellan. It was reviewed by another attorney and another return was prepared by him, and from the two of them the two returns that were prepared by outsiders, the one, and the one that was prepared by me originally, I prepared another return; from the first, the second one and the third one.

Now, whether or not I used some of the sheets of that first one in the preparation of the fourth one, I can't tell you, I don't know, but all I can say is this: I don't know if Mr. Ferrari resigned another one or not, but I can say they signed one and they signed this last one that has been filed.

Q. They did sign a return in your office prior to the expiration of the extension in December of 1947?      A. That's correct.

Q. That is correct. Now, did Mr. George and Edward Ferrari consult with you from time to time with respect to the valuations involved in the return?

A. Yes, we did, we talked about that on many occasions.

Q. On many occasions. And when did these conversations commence, do you recall?

A. Well, I'd say practically from the start, right from the early stages of the probate proceedings. They came to my office whenever I requested them to come, and we discussed different phases of the

(Testimony of Lloyd J. Cosgrove.)

estate, and also we discussed the valuations of [96] the estate.

Q. To your knowledge did they participate in any conferences or consult with anybody in your presence with reference to these valuations?

A. Not that I know of.

Q. I see. A. Not that I recall, even.

The Court: When was this last return filed. I am a little confused now.

Mr. Howard: This last return, your Honor, was filed on April 9, 1949, I believe. I am sure it was in the month of April, 1949. I have forgotten the exact date.

The Court: That was about a year and a half after the fifteen month period had gone by?

Mr. Howard: Yes.

The Court: Approximately.

Mr. Howard: Yes; a year and six months, exactly.

The Court: Then he speaks of another return which he doesn't say was filed, left with Mr. Doyle prior to the expiration of that fifteen months, within that period of time in which the one month extension was granted.

Mr. Howard: That is correct.

The Court: Was that filed?

Q. (By Mr. Howard): Well, Mr. Cosgrove, what happened to that return you left with Mr. Doyle? [97]

A. The return was left with Mr. Doyle for his observation and to look it over, and with the ex-



(Testimony of Lloyd J. Cosgrove.)

planation on my part that the return was incomplete and the further reason that we didn't have the money to pay the tax—it was around \$100,000 that was involved in this tax—and the family, Ferrari family, did not want——

The Court: All I want to find out is what happened to that, where is that paper?

Mr. Howard: I will ask the witness what happened to that return, Mr. Cosgrove.

A. Well, I will repeat it, if you don't mind, your Honor, what I just stated.

The Court: I wasn't interested in the conversation, all I am trying to find out is just the simple question, what happened to the paper; was it filed there, was it returned, or what happened?

Q. (By Mr. Howard): Was it filed there and was it picked up then, Mr. Cosgrove?

Mr. Gillard: I will object to the question; counsel is assuming something not in evidence. There is no testimony by this witness this return was filed; I object to the use of that term.

The Court: All I am trying to find out is what became physically of the document.

Mr. Howard: I will substitute the word "left."

The Court: I just want to get a simple answer.

Q. (By Mr. Howard): The return was left with Mr. Doyle's office, is that correct, Mr. Cosgrove?

A. That is correct. But if your Honor would like me to answer your question, I could answer it briefly.

The Court: You can, but all I am trying to find

(Testimony of Lloyd J. Cosgrove.)

out is some physical fact, that's all. The paper was left with Mr. Doyle. What became of that paper after that, that's all I want to know.

Q. (By Mr. Howard): What about that, what happened to that paper afterwards?

The Court: I will leave the rest of the examination to counsel.

The Witness: In the course of time it was thrown away with the rest of the reports as to the portions that were not used or were not needed in this last return that was actually filed.

The Court: Then it must have been returned to you?

The Witness: It was, your Honor.

The Court: What?

The Witness: It was.

The Court: Now, go ahead.

Q. (By Mr. Howard): Now, after the Ferraris had signed the return in your office, Mr. Cosgrove, did you communicate to them anything with respect to your conversations with Mr. Doyle [99] relating to the subsequent change and amendment of that return? A. No, I wouldn't—I didn't.

Q. Now, then, when was the tax paid, to the best of your recollection?

A. I can't recall. I know I delivered the check down to the Collector's Office. Do you happen to have a photostatic copy of that check?

Q. How did the payment of the tax come about?

A. I was delivered—well, I went with the Ferrari boys, two of them, and we went to the Bank of

(Testimony of Lloyd J. Cosgrove.)

America and we made application for a loan. We got sufficient monies from a loan, promulgated by the rentals that were accumulated over a period of time to pay the tax.

So the two boys came to my office, we wrote out a check for the tax liability as set forth in the return.

I took the check, which was in excess of \$100,000 to the office down there and said to Mr. Doyle, "I am prepared now to pay this tax. But in order to have the correct picture of the liability, the valuations should be changed on the return that you have, and also I should be privileged to claim a few more deductions for liabilities."

I started to make the change on the return that he had, which I left with him originally, and as I was writing and making these changes, Mr. Doyle, he says, "You better take it and make a clean job of it." [100]

I took that return and I brought it out to my office and I instructed my girl to prepare a new return, or correct the old return as much as she possibly could, and between that first return and the second prepared by Prior & McClellan and the next one prepared by another attorney, and the memoranda, or the instructions I gave her at that time, the return, final return was prepared in my office and I sent that down to the clerk's office.

The Court: How much time elapsed from the time you first left this return with Mr. Doyle to the time that you finally filed the completed return?

The Witness: I would say approximately a year

(Testimony of Lloyd J. Cosgrove.)

and a half, your Honor. And that was made——

The Court: How long a period of time did Doyle have possession of this document you left with him?

The Witness: I would say for that entire period.

The Court: The entire period of time?

The Witness: I would say that. He called me at different times telling me to clean it up and pay it. My answer to him at all times was that we were not in a position to pay that at this time, but we hoped to have the money shortly. That went on for a long period of time, it is true.

The Court: The payment of the tax was made coincident with the filing of this final return?

The Witness: Yes, your Honor. I took the check down [101] there with the intentions of making corrections on it. I left the check and took the old return out. I sent the new return down to them that same day, as I recall, and I sent them a check for the interest down at the same time.

Q. (By Mr. Howard): You sent him a check for the interest on the liability from the date of the payment, is that right?

A. From the date the payment was due until the date it was paid.

Q. Until it was actually paid.

A. Until it was actually paid.

Q. Had you advised your clients of the necessity of paying interest?      A. Yes, I did.

Mr. Howard: I have no further questions.

The Court: Well, before the cross-examination we will take a brief recess.



(Testimony of Lloyd J. Cosgrove.)

(Short recess.)

Mr. Gillard: Did you finish?

Mr. Howard: Yes.

Mr. Gillard: I suppose, to make the record complete, certain preliminary matters which are duplicative should be in this record likewise, it should be deemed to be a separate record, if the Court please?

The Court: You make whatever record you wish to make. [102]

Cross Examination

Q. (By Mr. Gillard): Mr. Cosgrove, with reference to this matter, which is the Ferrari estate, in connection with the questions I asked you before with reference to the Ferraris, did you hold yourself out to be an expert in Federal estate tax matters? A. No, sir.

Q. Did the Ferraris, and when I say the Ferraris, I am referring to George and Edward Ferrari, the executors of the estate of Luigi Ferrari, did they ask you whether or not you were an expert in Federal estate tax matters?

A. I don't think they asked me, sir. They recognized me to be not an authority, but they recognized me to be fully qualified to handle the administration of the estate of their father, though.

Q. Did you discuss with them at any time the fact that it would be necessary to refer out to somebody else the preparation of the estate tax return?

A. I told them, undoubtedly told them I was going to do that, but it wasn't necessary. I have handled lots of them myself without the assistance



(Testimony of Lloyd J. Cosgrove.)

of any so-called experts, but sometimes in order to satisfy a client you go out and you exhaust all remedies to see that the thing is done right.

I knew, and they told me they were very much interested in saving all that they possibly could as far as [103] taxes were concerned; they didn't want to pay out anything more than they had to pay. So I told them that I would consult others and be sure that it was properly filed and properly done, and that they paid the minimum amount of tax.

Q. Do you have an indemnity agreement with the Ferrari brothers, also, Mr. Cosgrove?

Mr. Howard: I am going to object to that question upon the ground, same grounds on which I previously made the objection in the case of the Ferrando estate.

The Court: Overruled.

A. Whether or not it is an indemnity agreement, I think, is a question of law.

The Court: Have you a similar arrangement with the Ferraris you testified you had with the Ferrandos?

The Witness: In substance it is the same, your Honor, excepting this: That from the start I verbally assured them and told them they wouldn't suffer anything because of my conduct, that I would see that they suffered no loss, and I was told by one of the Ferraris just recently they heard I gave a letter out to Mr. Ferrando, or Mr. Aliotto gave it to Mr. Ferrando, and they likewise would want something in writing from me to the effect that

(Testimony of Lloyd J. Cosgrove.)

they would be reimbursed if they had to suffer any loss.

I understand Mr. Aliotto gave such a letter to the Ferraris, and if he did it was with my authorization and [104] permission.

The Court: You authorized it?

The Witness: Surely.

Q. (By Mr. Gillard): Do you know the amount that is involved in this action on behalf of the Ferraris, Mr. Cosgrove?

A. I believe it is in the neighborhood of \$30,000.00.

Q. Yes, sir.

Mr. Gillard: If the Court please, in order to save additional exhibits in the case, you will recall that in the Ferrando matter as Exhibit E I marked one letter of the return in the Ferrari case. Would it be confusing if I asked the entire return be marked as an exhibit in this case?

The Court: You're referring to the letter that was a part of the return?

Mr. Gillard: That is correct, your Honor.

The Court: Now you want to offer the entire return in this case?

Mr. Gillard: Yes, your Honor.

The Court: The Ferrari return. Very well, that will be Exhibit what?

The Clerk: Defendant's Exhibit A in case 34,587; that's Ferrari versus the United States.

Mr. Gillard: For identification.

The Clerk: For identification.

(Testimony of Lloyd J. Cosgrove.)

(Whereupon entire return was received and marked [105] Defendant's Exhibit A for identification only.)

Q. (By Mr. Gillard): I show you Exhibit A for identification, Mr. Cosgrove, and ask you if this is the return, or a photostat of the return that you testified you took to Mr. Doyle in December of 1947 and left with him?

A. I would say part of that is a part of the return that I took to Mr. Doyle in December of 1947.

Q. This return that you have before you then, Exhibit A, is the return, is a copy of the return that was filed in April of 1949, is that correct?

A. That is correct. This is a photostatic copy of the return as filed in 1949.

Q. Now, as I understand the situation, then, it is your testimony that in December of 1947 you prepared a sort of a preliminary type of return which had estimated valuations in it, had that signed by the Ferraris, and took it down and left it with Mr. Paul Doyle in December of 1947, is that correct?

A. I would say that is correct.

Q. And then you went back in April of 1949; that return was still in a basket on his desk?

A. It was on his desk—it was in his possession, anyway.

Q. Now, sir, between those two times you had referred this matter to the firm of Prior & McClellan for the purpose of preparation of a completed return, is that correct?

A. I referred the matter to Prior & McClellan—

(Testimony of Lloyd J. Cosgrove.)

well, you [106] might say for preparation of a return.

Q. And was that subsequent to the time that you received the inventory and appraisement in the estate?

A. I would say it was either subsequent or about that same time.

Q. Do you know when the inventory and appraisement was received?

A. If I might be in a position to state if I was to see the inventory. I have no independent recollection on it, though, otherwise.

Q. I have the estate file, Superior Court estate file, it is file No. 104,168, and without bringing it to you, Mr. Cosgrove, I will advise you that the oath of the appraiser, W. A. Breen, was executed on the 26th of November, 1947. I will show it to you.

A. May I have your question, sir?

Q. Was that the date you received the inventory and appraisement from the appraiser?

A. Looking at this—the proceedings involved in this, in these matters, in the estate matters, is that the attorney prepares the inventory, sends it to the appraiser for his appraisement; the appraiser sets forth on the inventory, the attorney prepares his idea of the valuations. Mr. Breen, on this document, and the oath of appraiser, states that he received it on or about the 26th day of November, 1947. [107]

Q. He received it?

A. That is what he states here.

Q. He received your——



(Testimony of Lloyd J. Cosgrove.)

A. My inventory.

Q. I see. A. For his appraisalment.

Q. Does the file indicate when he returned it to you or filed it? Well, the file indicates when it was filed in the Superior Court; does the return indicate when he returned it to you?

A. No, it wouldn't indicate that, sir.

Q. So then from that file there is no way for you to ascertain when you received the appraisalment?

A. I wouldn't be in a position to tell you, sir.

Q. In any event, sometime after December of 1947 you referred this matter to Prior & McClellan, and they prepared an estate tax return, is that correct? A. That is correct, sir.

Q. Was that return shown to the Ferrari brothers? A. It was, sir.

Q. You recall when that was, sir?

A. No, I wouldn't be—I really don't know. Conservatively stating, I would say it was handed over to them a few days after it was sent to me by Prior & McClellan.

Q. Do you recall what the amount of tax was that was shown [108] on that return?

A. In the neighborhood of \$108,000.00.

Q. \$108,000.00? A. Yes.

Q. Would that, sir, have been around January or February of 1949?

A. I am at a loss to tell you; I don't know, sir.

Q. Do you know when the matter was referred to Mr. Baier, Mr. Baier was the man who prepared the other return?



(Testimony of Lloyd J. Cosgrove.)

A. Mr. Baier prepared one return.

Q. That was after the Prior & McClellan return had been given to you?

A. That is right, sir.

Q. You recall that Mr. Baier, at the last trial, indicated that he was contacted in this matter around February or March of 1949?

A. May I correct that last statement, I think I made a mistake, if I may, your Honor. I don't know if Mr. Baier prepared one or not, but I do know this: That I gave it to the Ferraris and they told me that they showed or gave it to Mr. Baier. I do know that I had received one back wherein it was a revision of Prior & McClellan's report, and the tax, as indicated in that return, was around, in the neighborhood of \$101,000, and it bore the signature, or at least Mr. Baier said he signed that return. Whether or not he prepared it, I [109] don't know, but presumably comes from his office.

Q. Let me put it this way, sir: At the time you received the Prior & McClellan return, whenever it was, at that time that return showed around \$108,000 in tax liability, is that correct?

A. That is my recollection of it, sir.

Q. That was approximately \$8,000 in excess of what you had indicated to the Ferrari brothers the tax would be the previous December, December of 1947?

A. That's right.

Q. Was that difference, that \$8,000, was that what caused them to want the matter to be reexamined by somebody else?

(Testimony of Lloyd J. Cosgrove.)

A. I really can't tell you what caused them to, but they told me that the tax was high, and I told them in my opinion and in the opinion of certified public accountants we had, it was properly prepared, but they were at liberty to take that out to anybody they wanted to and see—let them look it over and see if they can save them any money, I would be happy to work with anyone they selected.

Q. At that time, at the time you were talking, discussing with them the Prior & McClellan return, did they ask you when the return was due, either one of them ask you when the return was due to be filed?

A. No, sir.

Q. Did either one of them, George or Edward Ferrari ever ask [110] you if a return had been filed in the estate prior to April, 1949?

A. I don't believe they ever asked me.

Q. There was an extension of time secured in this case, was there not, sir, to December of 1947?

A. There was a thirty days extension secured.

Q. Until December, 1947?

A. I am not sure, but I think that is what that extension states.

Q. Did either one of those gentlemen, George or Edward Ferrari, ever ask you after that extension was secured if a return had been filed pursuant to that extension?

A. I have no recollection on that, but the facts are the extension was secured, and during that period of time the return was filed. Now, I don't know if I told them that or not, I can't recall whether

(Testimony of Lloyd J. Cosgrove.)

or not I told them, but I am under the impression that subject did not come up.

Mr. Gillard: Will you mark this?

The Clerk: Defendant's Exhibit B marked for identification.

(Whereupon preliminary estate tax notice was received and marked Defendant's Exhibit B for identification.)

Q. (By Mr. Gillard): I show Exhibit B for identification, Mr. Cosgrove. That is that preliminary estate tax notice that I showed you in the other matter. A. That's right, sir.

Q. Was that executed by George and Edward Ferrari in your office?

A. Yes.

Q. Then how was it filed with the Collector, if you know?

A. I wouldn't know; I don't know.

Q. Do you know if you took care of the filing of it, or either one of the executors did?

A. Either I took care, took care of the filing or someone at my instructions took care of the filing, that is someone in my office, and I might have mailed it down, I am not sure. I have no independent recollection as to when that was signed, why it was signed other than they evidently requested it from me in the Internal Revenue, but how it got to them, I don't know.

Mr. Gillard: I offer Exhibit B in evidence.

The Court: All right, admitted.

What did you do about Exhibit A?

(Testimony of Lloyd J. Cosgrove.)

Mr. Gillard: I was just going to ask about that. I will offer Exhibit A in evidence, if I didn't do so. Any objection?

Mr. Howard: No objection, Your Honor.

The Court: A and B admitted.

The Clerk: Defendant's Exhibit A and B admitted into evidence.

(Whereupon Defendant's Exhibit A and B heretofore marked for identification only, marked in evidence.)

Mr. Gillard: Q. Subsequent to the time that George and Edward Ferrari signed Exhibit B, did they ever make any inquiry [112] of you as to whether or not an estate tax return was filed with the Collector?

A. I am not sure, I don't know; they might have. I don't know.

Q. You have no recollection of it, sir?

A. No, sir.

Q. Do you have any recollection——

A. I do have a recollection of telling them on different occasions, and on many occasions that they better go out and raise some money to pay the tax, because that was a constant annoyance of mine, and I know it was an annoyance to them, too.

Q. Did you ever have, though, sir, do you recall any conversation with either one of the executors with reference to when the return was due?

A. I have no recollection on that subject, sir.

Q. When the return was delinquent?

A. No.

(Testimony of Lloyd J. Cosgrove.)

Q. What the penalty was for delinquent filing?

A. We never discussed penalties or delinquent filings, because that never entered my mind, never entered their mind, and I was assured—not assured, but I knew that I was protecting the rights of the clients because I had a return on file.

We did discuss on many occasions the payment of the tax and the payment of the interest on that estate.

Q. Now, sir, this Exhibit B was executed [113] in your office in your presence, was it?

A. I would say so, because I am of the opinion now all papers pertaining to that estate as far as executors are concerned, were signed in my office.

Q. Did they read the notice, Mr. Cosgrove, in your presence?

A. I doubt it, I doubt it. I don't know, but it is the usual practice to present papers to clients and they sign it when you tell them to sign. You explain what it is, as a rule, but seldom——

Q. At the bottom of the form just beneath their signatures there is appended these words: "Failure to file a required return on Form 706 within fifteen months from the date of death may render executors, administrators, and persons in actual or constructive possession of the decedent's property liable for penalties."

Did they discuss that with you at that time?

A. No, sir.

Q. Ask you any questions about that notice?

A. No, sir.



(Testimony of Lloyd J. Cosgrove.)

Mr. Gillard: I will hand to the Clerk and pursuant to stipulation of counsel ask to receive into evidence the estate tax record of the Collector's office with reference to the estate of Luigi Ferrari which shows, among other things, that this Form 704, which is Exhibit B, was filed on December 1, 1947. The date on the form itself is a little bit illegible, I wanted [114] to put the estate card in to show that date.

The Court: All right, admitted.

The Clerk: Defendant's Exhibit C introduced and filed into evidence.

(Whereupon "Estate Tax Record" Treasury Department Form 842 received and marked Defendant's Exhibit C in evidence.)

Mr. Gillard: Q. Mr. Cosgrove, then after this discussion with the Ferraris about the size of the taxes shown on the McClellan return, Mr. Baier was employed by them, or by you, to prepare a further return?

A. I don't know what the basis of employment, or if there was any employment between them, I don't know. However, I had nothing to do with it at all.

Q. In any event, did you eventually receive from Mr. Baier, copies of a prepared estate tax return in this Ferrari estate?

A. I did.

Q. You received how many copies, sir?

A. I don't know; I really don't know.

Q. You received an original and three copies, did you not, sir?

A. I couldn't tell you.

(Testimony of Lloyd J. Cosgrove.)

Q. You don't remember that, sir?

A. No, I really don't know if I received it directly from Mr. Baier. I answered yes, but I assume you mean that it came from the Ferraris or from Mr. Baier anyway. [115]

Q. How many copies of the return did you receive from Prior & McClellan?

A. I would say I received about four or five.

Q. Do you recall that you received at least an original and one copy of the return from Mr. Baier, of the return he prepared?

A. I really don't recall. I do know this: That he prepared one, I saw one and I saw his signature on one, but whether or not more than that was delivered to my office or left with me, I couldn't tell you.

Q. How many returns are required to be filed with the Collector?

A. Lately I have been filing one. I think in those days it was common practice to file two.

Q. An original and a copy, is that correct, sir?

A. That's right.

Q. Then there would be at least one copy for your file, is that correct?

A. What case are you referring to now, what specific instance?

Q. Ferrari.

A. I prepared them, I had all the copies. When Prior & McClellan prepared them, it was their practice was to send out, at that time, two to be filed, and at least two more, I would have at least two

(Testimony of Lloyd J. Cosgrove.)

more, maybe three copies. Now, what was done in this specific case, my recollection isn't clear on it other than the fact I received, I would say [116] I received four or five in all.

Q. At the time that you went down to Mr. Doyle's office in April of 1949, to file a return or to take care of this matter you had with you, did you, copies of the McClellan return?

A. I didn't really go down to file, I went down to pay the tax at that time and to correct the one I had there.

Q. I see. Went down to pay the tax.

A. And correct the one he had there.

Q. Did you have in your possession at that time copies of the McClellan return? A. I did, sir.

Q. Did you have in your hands at that time copies of the Baier return? A. Yes.

Q. Is that Baier or Baier?

A. I have heard it both, but I believe it is Baier.

Q. B-a-i-e-r, is that correct?

A. I understand it to be Baier.

Q. Were either of the returns that you had in your possession, that is, the return prepared by Prior & McClellan or the return prepared by Harry Baier, signed by the executors?

A. I doubt it.

Mr. Gillard: Will you mark this, please?

The Clerk: Defendant's Exhibit D marked for identification. [117]

(Whereupon estate tax return on the estate

(Testimony of Lloyd J. Cosgrove.)

of Luigi Ferrari marked Defendant's Exhibit D for identification only.)

Mr. Gillard: Q. I will show you, Mr. Cosgrove, Exhibit D for identification. This was Exhibit No. 29 in the last criminal trial and was introduced to the testimony of Mr. Harry Baier as an office copy of the return he prepared and sent to you. You recognize that document as such, sir? A. No.

Q. You recall seeing it before in the criminal trial? A. I don't recall it, sir.

Q. Will you look at the third page, sir, where it lists the attorneys for the estate and I will ask if that helps to refresh your recollection as to having seen it before?

A. Whether or not I saw this one before I couldn't tell you, sir, but——

Q. Mr. Cosgrove,——

A. But I do say——

Q. Pardon me?

A. I do say I did receive one of these. I know I saw one, might have been more than one.

Q. Maybe I misphrased my question. Is this return which is before you, Exhibit D, to the best of your recollection right now an exact copy of the return that was forwarded to you by Mr. Baier and which you had in your possession when you went to see Mr. Doyle?

A. I have no independent recollection as to [118] what was on that, on the one that I had. I am not in a position to testify whether or not this is an exact copy or not.

(Testimony of Lloyd J. Cosgrove.)

Q. Exhibit A herein, Mr. Cosgrove, contains a copy of the extension of time that was secured in the case, and it also contains a photostatic copy of the will attached to it. With the exception of those two additions, sir, will you tell me what the difference is between Exhibit A and Exhibit D?

The Court: Are they the same? I mean, I don't want to take time to have somebody else compare it. Has somebody compared them, are they the same?

Mr. Gillard: Well, maybe counsel will stipulate with me.

The Court: I would think so. I mean, what is the good of having a man look at two documents and taking time to see whether they are copies or not.

Mr. Gillard: Sheet three, which contains the names and addresses of attorneys for the estate on Exhibit A merely specifies Cosgrove, Molinari and Tinney, and Exhibit D, in addition to those names, contains the name of Harry H. Baier. The return, with that exception, is exactly the same until the signature page, which is sheet twenty-one, and in this Exhibit D that signature page is not filled in. With that exception, counsel having examined them, I think he will find every figure, every appraisal, every item is exactly the same.

Mr. Howard: If Your Honor please, these returns are typed on different typewriters and they contain very extensive [119] descriptions of real



(Testimony of Lloyd J. Cosgrove.)

property, and it would take me hours to compare them to see if they are exactly the same.

The Court: If it is material the comparison can be made. The purpose is to show that the Baier copy is substantially the same as the Exhibit C, which was the return that was finally filed?

Mr. Gillard: Exhibit A, Your Honor; yes.

The Court: Exhibit A, which was the return that was finally filed, is that right?

Mr. Gillard: Yes, Your Honor.

The Court: In other words, your purpose is to establish the fact that the return as filed was the Baier return, putting it colloquially?

Mr. Gillard: That's right.

The Court: Well, the physical facts will speak for themselves. You can argue that.

Mr. Howard: I will stipulate, first of all, that this is a copy of the return that Mr. Baier prepared and furnished to Mr. Cosgrove.

The Court: You will stipulate to that?

Mr. Howard: Yes, I will stipulate also that the—well, I have been through this before, I am quite sure I can stipulate that this return contains substantially the information contained in the return filed by Mr. Cosgrove on April 22, 1949.

I would like the record to show, however, [120] that the information contained in the return filed is not an exact copy of the information contained in the Baier return. It was typed on a different typewriter and set up in a different manner. The infor-

(Testimony of Lloyd J. Cosgrove.)

mation itself corresponds with the exception that counsel for the Government has indicated.

Mr. Gillard: Physical comparison can be made to show it is not an exact—one is not a photostatic copy of the other, but the words and figures are the same; with that exception, is that correct?

Pursuant to that stipulation I will offer Exhibit D in evidence, if the Court please.

The Court: All right.

The Clerk: Defendant's Exhibit D admitted in evidence.

(Whereupon Defendant's Exhibit D heretofore marked for identification only was marked in evidence.)

Mr. Gillard: Q. Now, Mr. Cosgrove, isn't it true that you knew and you now know that the return that was actually filed with Mr. Doyle in April, 1949, with the exception of the sheet three, which contained the names of the attorneys, was an exact duplicate of the copy of the return that was furnished to you by Mr. Baier?

A. As counsel, Mr. Howard stated, the items might be the same on that as furnished by Mr. Baier, but the order is not the same, and we can go further and say that Mr. Baier's report is identical to the report as furnished by [121] Prior & McClellan with the exception of one elimination, one or two eliminations as to property.

Q. That's not the question, Mr. Cosgrove, I didn't ask you anything about the Prior & McClel-

(Testimony of Lloyd J. Cosgrove.)

lan return. The Prior & McClellan return showed a tax liability of \$108,000, didn't it?

A. That is correct.

Q. And this return shows a tax liability of 101 thousand odd dollars?

A. Because that shows there were one or two parcels eliminated from that last——

The Court: What counsel is trying to get at, did you or did you not use the Baier, so-called Baier return, estate return which you filed?

The Witness: I can't answer that yes; the answer is no.

The Court: Well, it shows the same tax liability?

The Witness: Yes, Your Honor.

The Court: Same data was used?

The Witness: The data was used from the Prior & McClellan, and Prior & McClellan got that information from me, except in the last one when Mr. Baier got the report in his hands, he eliminated a couple of parcels of property from the report, and that's the reason for the reduction in the tax liability. Those parcels that were eliminated by that report were subsequently replaced, was put in on the estate return after the audit was made. [122]

The Court: If that is the case, then, they are not copies, they are not the same.

Mr. Gillard: I am sorry, your Honor, I was——

The Court: The witness has just said there were a couple of parcels of property that Baier eliminated in his report, thus reducing the tax. Those

(Testimony of Lloyd J. Cosgrove.)

parcels were, however, included in Defendant's Exhibit A, the return that was actually filed.

The Witness: I am sorry, your Honor, please.

The Court: You didn't say that?

The Witness: I didn't mean it that way, no. The Exhibit A contains the two, the same amount of parcels as used by Mr. Baier, but on audit by the Revenue Agent later they came back and re-inserted it.

The Court: Now you are interjecting something else. Can't we settle this matter? It seems to be a very simple matter, I don't know what the importance of it is, but apparently from what Mr. Gillard said and what the attorneys are willing to stipulate to, the Baier report, return, is the return that was used in Defendant's Exhibit A, the return that was filed. At any rate, physically they are the same except for the differences that have been specified?

Mr. Howard: The information relating to the assets and the computation of tax, and so on, in the return that was filed, Exhibit A, is identical to the corresponding information in the Baier return.

The Court: With some exceptions which have been stated?

Mr. Howard: Yes, with the exception of sheet three, and with the exception of the signature page on the return.

The Court: All right now, we have covered that.

Mr. Gillard: Thank you, Mr. Howard.

Q. (By Mr. Gillard): Now, sir, then at the time



(Testimony of Lloyd J. Cosgrove.)

you went down to Mr. Doyle's office for the purpose of paying the tax, you also went down for the purpose of filing this second return, is that correct?

A. No, sir.

Q. You didn't go down for the purpose of filing a return? A. No, sir.

Q. What was your purpose in addition to paying the amount—incidentally, was the check that you had in your hand at the time you went down to Mr. Doyle's office for the amount of tax shown on the Baier return, which is in your possession?

A. That is correct, the check was in the same amount.

Q. Exactly the same amount? A. Yes.

Q. Now, in addition to going down to Mr. Doyle's office for the purpose of delivering that check, what were you going to do as far as the return was concerned?

A. I was doing nothing with that return other than—I went down for the purpose of conforming the return that he had there with the three returns that I had in my possession. [124]

Q. In other words, your purpose was to conform this return that you say Mr. Doyle had with the copy of the Baier return you had in your hand, is that correct?

A. That is right, plus the return of Prior & McClellan that I had in my hand and plus the original return that I had.

Q. Let's get this straight, Mr. Cosgrove. Was the return that you filed similar to the Baier return



(Testimony of Lloyd J. Cosgrove.)

or similar to the Prior & McClellan return?

A. No, it was similar to the return I had in my hand that I prepared myself. The audit of the properties—I don't know how they were set forth in my original, nor do I know how they were set forth in Mr. Baier's, but I know there was a difference in the manner in which they were set forth.

The Court: We are taking an interminable time to establish a very simple fact. Whatever you may call the returns, what you had in mind doing was substantially making the return that you say was in Mr. Doyle's possession conform in substance to the data contained in the Baier return; whether or not you had other returns, the information set forth in the so-called Baier return you wanted to amend on the face?

The Witness: On the face.

The Court: Of the return that Doyle had.

The Witness: In substance that is correct.

The Court: In substance that is correct?

The Witness: Yes. [125]

The Court: So that was one of your purposes as well as paying the tax at that time?

The Witness: That is correct.

The Court: Now, take it up from there.

Q. (By Mr. Gillard): Mr. Cosgrove, instead of marking up this return you say Mr. Doyle had and then taking it back and retyping it, wouldn't it have served your purpose just as well and been a lot simpler for you merely to have filed a copy of the Baier return you had in your possession?

(Testimony of Lloyd J. Cosgrove.)

A. I didn't consider that. I considered the paper that Mr. Doyle had down there to be the return, and at the same time I am reasonably sure and almost positively sure the Ferrari boys did not sign the Baier return. And also I might add further that Mr. Baier wasn't the attorney for that estate.

Q. Before you went down there to Mr. Doyle's office for the purpose of correcting on its face this return that was filed, you, of course, as the attorney of the estate and doing the proper thing, checked the regulations to find out whether or not you could change that return, didn't you, Mr. Cosgrove?

A. No, I didn't check it.

The Court: Why didn't you take the return you subsequently filed as Defendant's Exhibit A with you and file it in substitution of the other one at the time?

The Witness: Because it didn't have the signatures on it, your Honor. [126]

The Court: I mean, why didn't you get the signatures, or have it signed up and take it down when you sent the check down and say to Doyle, "Put it in place of the other one."

The Witness: Because I thought the other one was filed properly even though the information on it wasn't complete; I thought that it was a proper filing.

The Court: I am not talking about that end of it. Assume it was a proper filing, it seems to me a rather stupid performance to go down there and to correct the other return when you could have

(Testimony of Lloyd J. Cosgrove.)

just simply substituted the one that you wanted to file.

The Witness: Might have been reasons at the time that existed that I didn't want to file it, and, of course, as we all appreciate, hindsight is better than foresight, too.

Q. (By Mr. Gillard): Was the return you say Mr. Doyle had, did he have this return in his desk for this period of a year and half, Mr. Cosgrove?

A. I don't know where he had it for a year and a half.

Q. At the time that you saw it in April of 1949 when you started to make these corrections on it, as you say, was there a filing stamp on it?

A. That I couldn't tell you.

Q. By filing stamp, sir, I mean the stamp which is on the upper right-hand corner of the face of the return which is the space reserved for the stamp by the Collector's office. Is that what you understood that to mean, sir? [127]

A. I understood you to say that.

The Court: Well, they would hardly give him back an official document, because if it was officially marked filed there must have been some record of it in the Collector's office.

Mr. Howard: I might point out, your Honor, the estate tax records counsel offered in evidence indicate that the return was filed on December 2, 1947, for whatever significance that might have.

Mr. Gillard: Are you going to assert that in this

(Testimony of Lloyd J. Cosgrove.)

case, Mr. Howard, as the contention of the plaintiff?

The Court: I am sorry, I didn't get what you said.

Mr. Howard: I was just pointing out counsel offered in evidence an estate tax record which I stipulated was a true and correct record.

The Court: Let me see that. That was Exhibit C?

Mr. Gillard: A.

Mr. Howard: Talking about this record, estate tax record here.

Mr. Gillard: This is taken from Exhibit A, obviously. I want to understand this, if the Court please, I want to find out what Mr. Howard means by this.

Mr. Howard: I am not making any contention on the basis of that at all.

The Court: Got some kind of a mark here, shows it was [128] 12/2/47.

Mr. Gillard: That is correct, your Honor.

Q. (By Mr. Gillard): Mr. Cosgrove, that date the Court just referred to, December 2, 1947, that is the date that appears on the return that you took to Mr. Doyle in April of 1949, is that correct?

A. Will you ask that question over again?

Q. The return that you took to Mr. Doyle in April of 1949, the return in the estate of Luigi Ferrari, is the return which was subsequently stamped "Filed" December 2, 1947?

A. I wouldn't know what it was stamped, sir.

(Testimony of Lloyd J. Cosgrove.)

Q. I will show you the original of the return—this is the original, if the Court please, that I am showing the witness, of Exhibit A which you have. Would you examine that document, please, Mr. Cosgrove?       A. Yes.

Q. Is that the document, the physical document in all of its parts that you delivered, and the whole of it, as it is right now before you, is that the document you delivered to Mr. Cosgrove in April, 1949?

Mr. Howard: You mean Mr. Doyle?

Mr. Gillard: Delivered to Mr. Doyle in April, 1949.

A. I would say it is, I have no recollection that good to tell me, but I believe it to be the same one.

Q. And thereafter Mr. Doyle, or somebody in the Collector's [129] office, backdated that return to December of 1947, is that correct?

A. No, that is not correct, sir.

Q. Somebody in the Collector's office put on that return that stamp of December 2, 1947, is that correct?

A. I wasn't present when the stamp was put on, I don't know when the stamp was put on, I don't know the date the stamp was put on, and I don't know this is the original face of the first return that was left with them or if it was the last return. I don't know when it was put on because I didn't see it put on.

Q. Now, I tried to cover that a minute ago, Mr. Cosgrove, and you ducked the question. Now, I will ask you again——



(Testimony of Lloyd J. Cosgrove.)

A. I beg your pardon, I didn't duck anything.

Q. All right, now, since you are now changing the tenor, I will ask you this question: At the time you went back to Mr. Doyle in April of 1949 to make these changes on the return you say you left with Mr. Doyle, was that stamp on there, that December 2, 1947?

A. That I couldn't tell you.

Q. All right.

A. I have no recollection on it.

Q. Then you can not say and you can not so infer to the Court at this point that this might be the same document, is that correct?

A. Will you please ask the question again? [130]

Q. I'll withdraw the question.

Mr. Cosgrove, wasn't the subject of the backdating of this return one of the subjects of the criminal trial in which you were engaged in?

A. Which I was freed of.

Q. That is correct, but I am merely asking you if by virtue of that trial——

Mr. Howard: Your Honor, please, I object to this whole line of testimony.

Mr. Gillard: You raised it, Mr. Howard, you raised it by calling attention to that filing date.

Mr. Howard: That was already in evidence.

The Court: You see, you got me a little confused, Mr. Howard, as to what claim you are attempting to pursue here in this case, whether it is a claim that the return delinquency did not occur or whether or not there is a basis for the refund on the claim that delinquency is excusable.

(Testimony of Lloyd J. Cosgrove.)

Mr. Howard: The basis of the contention here is that we proceeded on the theory that the return was filed, and the claim so states and the complaint so states, on April 22, 1949.

The Court: Well, I take it that you have some more examination, haven't you?

Mr. Gillard: May I just ask this—Mr. Cosgrove said that he was acquitted on these charges, or he was acquitted on the one charge and then he was retried and on which he was [131] convicted and reversed on the ground it was *res adjudicata*, and there is no inference——

The Witness: That was an acquittal.

Mr. Gillard: There was no inference being made on my question to Mr. Cosgrove that there was anything else besides innocence attached to him, I was merely trying to find out by virtue of his knowledge gained in the course of this trial if this wasn't the subject of the trial. I didn't mean to impute anything at all, Mr. Cosgrove, as far as anything else was concerned. But since Mr. Howard has raised this question I will ask for this stipulation from him, and if he will not so stipulate I am going to have to bring over the Internal Revenue Service and we are going to have to repeat the criminal here.

The Court: I am not going to conduct a criminal trial.

Your suit is not predicated upon any claim that the delinquency did not occur, but rather you are advantaging yourself of provisions of the regula-

(Testimony of Lloyd J. Cosgrove.)

tions which allows for the curing of the delinquency, or rather the nonforfeiture in the event that it appears that there was reasonable grounds for delinquency, reasonable excuse for delinquency.

Mr. Howard: That is right.

Mr. Gillard: I would like to further stipulate with counsel that Exhibit A in this case was actually filed in April of 1949.

Mr. Howard: I don't think that that stipulation is [132] necessary; it is in the pleading and admitted by the Government in its answer.

The Court: It is also stated in the pleadings in the complaint.

Mr. Howard: Yes.

The Court: And I assume necessarily that in the claim for refund that the return was filed in April of 1949.

Mr. Gillard: That is true, the complaint says there was filed in April of 1949 a return.

The Court: All you want to establish is that this is——

Mr. Gillard: Exhibit A is what the complaint refers to as filed in April of 1949.

The Court: That has already been admitted in evidence.

Mr. Howard: Admitted in evidence.

The Court: Shows it was filed in April of 1949.

Mr. Howard: Admitted in the answer.

The Court: I will make a finding to that effect now so we won't have to bother about it.

The record is sufficient to warrant a finding at

(Testimony of Lloyd J. Cosgrove.)

this time that Exhibit A is the claim referred to in the suit on file herein and was filed in April of 1949 in the Collector's office. I think that is sufficient to warrant that finding. Have you any objection to that?

Mr. Howard: No objection to that at all.

The Court: Mr. Gillard, it is twenty-five minutes to [133] five; and it is very obvious that we are not going to be able to conclude—do you have some more examination?

Mr. Gillard: I have, if I could be allowed about five minutes I think I could be finished with Mr. Cosgrove and we can excuse him, if the Court will indulge me that long.

The Court: If you want to do that it is all right, but we will have to continue this case, because we can't—

Mr. Gillard: Maybe it would be better then if it goes over and it will give me a chance to re-examine it.

The Court: Now, unfortunately I can't continue the case tomorrow, which I would have liked to have done so that we could have concluded it while it is in our midst rather than after delays, but I have already accepted an assignment to sit in the Court of Appeals tomorrow. I informed the Master Calendar Clerk of that fact and I guess, as sometimes happens, mismeasured the length of time that would be taken. So I can't hear it, finish it up tomorrow, which I would like to do, but I can't be two places at one time.

(Testimony of Lloyd J. Cosgrove.)

Monday, Tuesday, Wednesday, possibly Wednesday, I have another commitment to substitute for Judge Hamlin, who will sitting in a three judge case, so the best I could do, I think, would be for next Thursday. I know it's a long time, but I don't know what else to do about it. Is that all right for both of you?

Mr. Howard: Thursday is all right. [134]

The Court: You want to finish the case and perhaps argue it, and I would suggest that we do go over to that date to prepare just a memorandum, at least, of the authorities so that I can have that, and then you gentlemen could argue it at that time. That would give you time to argue that day, save the time of subsequent preparation of a memorandum.

Mr. Howard: Yes.

The Court: Would that be agreeable to you?

Mr. Howard: Perfectly agreeable.

Mr. Gillard: Yes, your Honor.

The Court: Then we will continue the further trial until next Thursday at 10 o'clock.

(Whereupon an adjournment was taken until Thursday, March 22, 1956, at 10 a.m.) [135]

Thursday, March 22, 1956, Morning Session

The Clerk: Ferrando versus United States for further trial and Ferrari versus United States, further trial.

The Court: I believe that there was a witness on the stand.



(Testimony of Lloyd J. Cosgrove.)

Mr. Gillard: Mr. Cosgrove was on the stand.

The Court: And you had some further cross examination?

Mr. Gillard: Yes, your Honor.

Cross Examination—(Resumed)

Q. (By Mr. Gillard): Mr. Cosgrove, I have placed before you the photostatic copy of the return in the Ferrari estate, Defendant's Exhibit A. I believe last week with respect to this return you indicated that an incomplete return was left by you with Mr. Doyle on or about December 2nd, 1947, and you stated that some of the valuations were missing from that return. The return before you is the one that, as I understand, was actually filed or taken to Mr. Doyle in April of 1949. Now, sir, going through this return, and for the purpose of ascertaining what was contained in the return that was left by you with Mr. Doyle on December 2nd, 1947, may we go through the return as filed and see what the additions have been? First, was the first document under the face of the return—that is, the letter from the Collector of Internal Revenue, dated October 31, 1947, which is an extension of time for thirty days to file the return—attached to the return you left with Mr. Doyle in December of 1947? [136]

A. I have no independent recollection on it, but I would say it was attached to it. I wouldn't know, though, but I believe it to be attached to it.

Q. All right. The next document is a certified copy of the last will and testament of Luigi Fer-

(Testimony of Lloyd J. Cosgrove.)

rari, showing that it was certified as being a true and correct copy by the Clerk of the Superior Court in San Francisco on June 22, 1948. Was another or different certified copy of the will left with the return that was filed and left with Mr. Doyle in December of '47?

A. I have no recollection on it, sir.

The Court: What was the date it was certified?

Mr. Gillard: June, 1948.

The Court: Well, it couldn't have been attached to the one——

Mr. Gillard: No, I asked him if another or different copy of the will——

The Court: Oh.

Mr. Gillard: ——earlier certified was attached to the return and left with Mr. Doyle in December of '47.

A. I have no recollection on that.

Q. (By Mr. Gillard): Do you recall that you secured from the Clerk of the Superior Court an earlier certified copy of the will?

A. I do not recall. I haven't checked my records and I do not know. [137]

Q. If that earlier return had contained a certified copy of the will, when you took that return from Mr. Doyle after making the corrections on it to your office for further preparation, would you not have attached to the copy as filed the same copy of the will you had with the earlier return?

A. I don't know what I would do, but common sense would tell me that I would not have secured another certified copy if I already had one.

(Testimony of Lloyd J. Cosgrove.)

Q. Is it your best recollection, then, Mr. Cosgrove, that with the copy filed with Mr. Doyle in December of '47, there was no certified copy of the will? A. I have no recollection on it, I told you.

Q. Now Sheet 2 of the return contains general information concerning the personal history of the people involved. Is it your recollection that that sheet was completely filled out in the return filed in December of '47?

A. I have no recollection on that question. I have no recollection on, probably, any one of these pages as you go along, sir. This page 2——

Q. Well, pardon me. Go ahead.

A. This page 2 contains the names of certain doctors who attended to the decedent. Now whether or not I had all of them at that time, I couldn't tell you. If we had them all at that time, those names would probably be on that original paper. If we didn't have the names at that time, they would [138] not have been on it. Now whether or not they were, I am not in a position to answer that.

Q. Let's turn to Schedule A, sheet 4, which is the schedule of the real estate, listing a total of six parcels with the valuations for those six parcels. Were any of the valuations shown on Schedule A on the return left with Mr. Doyle in December of '47?

A. Well, we had certain valuations on the sheet that was left. Whether or not they were the same valuations as on this sheet I have here, I have no recollection.

(Testimony of Lloyd J. Cosgrove.)

Q. Now I believe——

A. I am under the impression they were not the same valuations. However, I am not sure of it. I don't know; I have no recollection on it.

Q. Where would you have secured those valuations, Mr. Cosgrove?

The Court: Which ones?

Q. (By Mr. Gillard): The valuations you put on the return and left in December of '47 with Mr. Doyle?

A. The original valuations were only estimates.

Q. Was it your testimony, then, that you believe that certain estimated valuations for the real estate were placed on the return left with Mr. Doyle in December of '47?

A. We had all estimated valuations on it, sir.

Q. Now, when you testified last week that the return left [139] with Mr. Doyle did not have the valuations on it, what were you referring to?

A. I don't think that is my testimony.

Q. What was your testimony, Mr. Cosgrove, with reference to the omissions that were on the return left with Mr. Doyle in December of 1947?

A. What is my answer to that question, counsel?

Q. Yes, sir.

A. The return itself was incomplete. There was various information omitted from it which we did not have at that time. We did not have the money to pay it. The valuations were only estimates that were placed on the properties. Whether or not we had all the information on the original return as



(Testimony of Lloyd J. Cosgrove.)

filed, as we have—as the information we have on this last return, I am not in a position to state.

Q. Let me ask you the question again this way: Do I recall that last week you testified that the return left with Mr. Doyle in December of '47 did not have all of the valuations on it for the reason that you hadn't received the inheritance tax appraiser's report at that time?

A. I do not recall that as my answer. I do recall this, that the valuations on the properties that were originally—on the return as originally filed were only estimates. The valuations placed on this return, the return before me, have been taken from the inheritance tax appraiser's, or the [140] inventory and appraisal which is on file.

Q. All right, sir. Let's turn to Schedule E, sheet 8 of the return, which is a schedule of jointly owned property. There are two pieces of property listed there, the valuations on the one is \$180,000 and on the second is \$48,000. On the return left with Mr. Doyle in December of '47, were there valuations on those two pieces of property?

A. I have no recollection on that, sir. See, you are asking me information in matters that occurred in 1947-48. I can't recall that.

Q. Let's see. Turning to Schedule G, transfers during decedent's life time, three parcels are listed there with valuations of \$15,000, \$25,000 and \$12,000. Were any valuations contained on Schedule G on the return left with Mr. Doyle in December of '47?



(Testimony of Lloyd J. Cosgrove.)

A. I couldn't tell you, sir. As a matter of fact, I couldn't tell you if we had the matter listed that way or not, at that time. Looking at it now, my recollection is this, that that sheet was not filled out in this manner or form. However, I could be in error about that.

Q. Let's turn to Schedule O, sheet 18, Mr. Cosgrove. That sheet is a recapitulation of the assets and allowable deductions showing the total gross estate and the total allowable deductions. Was that sheet filled out on the return that was left with Mr. Doyle in 1947? [141]

A. Well, the sheet, sheet number 18, left with Mr. Doyle was filled out.

Q. It showed the gross estate?

A. Showed a gross estate, yes, sir.

Q. It had a figure in there for the gross estate?

A. That is correct.

Q. It had a figure in there for the total allowable deductions?

A. That is correct.

Q. Well, now, is it your testimony today, Mr. Cosgrove, that the return filed or left with Mr. Doyle in December '47 had some figure for every asset of the estate in it, even though it was an estimate?

A. Every asset that was listed on the return had a figure on it.

Q. Let's turn to Schedule P, sheet 19, the sheet which shows the total gross estate, the net estate and—the net estate. Were those figures filled in on the return left with Mr. Doyle in 1947?

(Testimony of Lloyd J. Cosgrove.)

A. What figures are you referring to, sir?

Q. I am referring to the figure for the total gross estate and the net estate in Schedules P and Q on sheet 19?

A. I would say that there were some figures in there, yes.

Q. And there were——

A. I am positive that it wasn't the same figures as set [142] forth here, though.

Q. All right. The following sheet, sheet 20, is a computation of the tax. Was that sheet filled in on the return left with——

A. Sheet Number 20 was filled in, yes.

Q. And there was a figure inserted in there for the amount of tax due?

A. Some figure was inserted in there, the figure that we wanted, tax we based upon our estimates of value of the properties less the deductions we had or knew at that time.

Q. All right. Then in what respect was the return incomplete, Mr. Cosgrove?

A. In this respect, that we didn't have the check to accompany it at first.

Q. Didn't have what, sir?

A. We didn't have the check, we didn't have the money to pay the tax in the first place.

Q. Where does that show on the return we have been discussing, that you had no money to pay the tax?

A. I think if you will examine this, there is

(Testimony of Lloyd J. Cosgrove.)

some place in here that says the return with the check should be filed.

Q. That is correct, sir, but we have been discussing the information placed on the return.

A. All right. Now——

Q. Where on the return is there a statement that there is [143] no check here?

A. There was no check accompanying it.

Q. I see. Now I will ask the question again, Mr. Cosgrove. In what respect was the return incomplete, the return?

A. The return was incomplete in many respects. The first respect is that there was no check accompanying it; the second respect is that we didn't have all the information concerning the liabilities; and the third, we did not have the valuations of the properties, we only had an estimate of the valuations of the properties. And that's three respects that the return was incomplete. And in those three respects, we explained it to the man that we left it with, with the Internal Revenue Department.

Q. In other words, the return on its face was complete, but you wanted to add further information or change those figures upon the receipt of additional information—for example, from the inheritance tax appraiser as to different valuations or to confirm your valuations—, is that correct?

A. If you want to put it that way, the return was complete, sir.

Q. Now at the time that the executors signed

(Testimony of Lloyd J. Cosgrove.)

this return in your office on October 31, 1947, did they examine that return?

A. I have no recollection, but I doubt it.

Q. Did you go through the return with them and indicate the [144] method by which you arrived at the gross estate and the net estate and the tax due?

A. My policy is always if they don't want to read it or if they wouldn't want to read a document or paper of this nature, I would explain every item on the page. I don't mean to say I would explain the regulations or anything; I would explain the inserts in most of the cases and the manner or the way in which we determined the tax liability.

Q. Am I correct in assuming, sir, when in my last question I asked you when they signed the return in October 31, 1947, that is the date they signed the return?

A. I would just assume it was the date that they signed it too. I have no independent recollection as to when they did sign it.

Q. Did they ask you if this was, this return was going to be filed? A. I doubt that.

Q. Did they ever ask you if the return had been filed? A. They might have.

Q. Do you recall if they did, sir?

A. I have a recollection that they did ask me. When or where or how or under what circumstances, I don't recall now. But I am under the impression now that they did ask me.

(Testimony of Lloyd J. Cosgrove.)

Q. And do you recall, sir, that you told them it had been filed? [145]

A. I would have told them that, yes.

Q. Did you, sir?

A. I don't recall. I say I have a faint recollection of them asking me that. If they asked me that question, I would have told them yes, it was filed.

Q. Now, sir, I will place before you Defendant's Exhibit B, which is the preliminary estate tax notice, and ask you when that was signed by George and Edward Ferrari.

A. I have no recollection when it was signed. It was signed during the period of the administration, though.

Q. Was it signed before or after the estate tax return was signed?

A. Well, I note it was signed before the estate tax return, or about the same time or prior thereto; but I have no independent recollection when it was signed.

Q. Either before or after?

A. It appears to me to bear their signatures, and I am reasonably sure I wouldn't ask them to sign it after the estate tax return was filed.

Q. Did you indicate on our last session that that preliminary notice had been signed after the extension of time was received, because this was an unusual situation—you said the preliminary notice was not ordinarily asked for, only in connection with an extension of time, and that it was after



(Testimony of Lloyd J. Cosgrove.)

you had received the extension of time that that preliminary notice [146] was asked for?

A. I don't remember my testimony last week as far as this paper is concerned, other than in this respect, that it is my recollection that this paper was signed by the two Messrs. Ferrari in my presence. I said it was a rather unusual thing, because they do not ask for this paper up in the Internal Revenue Department. As a matter of fact, they tell you you don't have to file it. I assumed at the time that this properly was asked of me to be signed because I asked for an extension of time. Now that's my recollection of what took place. That's my recollection of my testimony last week, and that's my recollection today.

Mr. Gillard: Would you mark this for identification?

The Clerk: Plaintiff's Exhibit 1 marked for identification.

Mr. Gillard: No, wait a minute. We are the defendants.

The Clerk: Oh, I am sorry. Defendant's Exhibit E marked for identification.

(Whereupon carbon copy of letter dated 10/22/48, further identified below, was marked Defendant's Exhibit E for identification only.)

Q. (By Mr. Gillard): Mr. Cosgrove, I will show you a rather tattered carbon copy of a letter dated October 22, 1948, and ask you if this was Exhibit Number 5 in the criminal trial and ask you if

(Testimony of Lloyd J. Cosgrove.)

you recall having received that [147] communication, the original of that communication.

A. I don't recall this.

Q. You have no recollection of that, sir?

A. No, sir. This letter is addressed to Ferrari in care of Cosgrove, Molinari and Tinney. Whether or not we received the original or if we received this, I have no recollection at this time. I don't know if I received that or not.

Q. Do you have any recollection at any time of discussing with the Ferrari brothers the problem of filing a return after or pursuant to the notice of preliminary return, which is Exhibit B, I think, before you?

A. May I have your question?

Q. Was the question as to when a return was going to be filed pursuant to that preliminary notice of estate tax return discussed with either of the executors?

A. I couldn't answer that now. I don't know.

Q. After the expiration of the thirty days extension of time which had been secured and which expired December 2, 1947, did you discuss with the executors the necessity for filing a return after the expiration of that extension?

A. My recollection is that I discussed with them many times their raising the money to pay the tax, and I always told them that I estimated the tax to be in the neighborhood of \$100,000. I would not have discussed with them the necessity of filing any return, because we considered the return was [148] already filed.

(Testimony of Lloyd J. Cosgrove.)

Mr. Gillard: Will you stipulate as to this, whether it was—(Balance of conversation among counsel out of hearing of the reporter).

Mr. Howard: I don't know what the relevancy is.

Mr. Gillard: Will you stipulate it may go in?

Mr. Howard: Yes.

Mr. Gillard: By stipulation, Exhibit E for identification may be admitted into evidence.

The Clerk: Defendant's Exhibit E admitted and filed into evidence.

(Whereupon Defendant's Exhibit E for identification was received in evidence.)

Q. (By Mr. Gillard): Sir, after this return was left with Mr. Doyle in December of '47, did you examine the statutes or the regulations for the purpose of ascertaining your power or right to amend that return?

A. No, sir, except other than what—other than by interviewing Mr. Doyle.

Q. And did Mr. Doyle advise you that the return could not be amended, but that only supplemental information could be submitted?

A. No, sir, he did not.

Q. He did not advise you. What did he advise you, Mr. Cosgrove? [149]

A. Take it out and make the corrections and bring it back.

Q. That was in April of 1949?

A. That's right, sir.

Q. Prior to the time you went to his office and started to scribble on that return and make those

(Testimony of Lloyd J. Cosgrove.)

corrections, had you talked with Mr. Doyle with reference to your right or power to amend that return?

A. I talked to him on a few occasions or several occasions during that interim period, but never discussed with him the province or the obligations or the extent of his authority or my limitations, either. Our conversation was confined at all times to, "When will you bring the money in to pay the tax on this estate?"

Q. And did you at any time make an examination of the statutes or the regulations to ascertain what your power was to amend or alter that return?

A. I didn't believe that I had any occasion to do it and I never did it, because naturally I relied upon the office of the Internal Revenue Department.

Q. And did Mr. Doyle, you say, prior to April of 1949, advise you you had the right to amend that return?

A. No, sir, he did not advise me.

The Court: You said from December of '47 to April of '49 it took the executors to raise the money to pay the tax?

The Witness: The answer I can give you, your Honor, is [150] this, that as soon as the money was raised, as soon as the money was secured, we went and paid the tax. I don't think an honest attempt was made at the start to get the money. I may be mistaken in that.

Q. (By Mr. Gillard): Well, Mr. Cosgrove, the money that was used to pay this tax was borrowed, was it not?

(Testimony of Lloyd J. Cosgrove.)

A. Money was borrowed from the Bank of America, supplemented by the accumulation of rents that was received from the property, which was used in the payment of tax.

Q. How much was borrowed from the Bank of America?      A. I couldn't tell you.

Q. \$90,000?      A. Probably so.

Q. And the tax was \$100,000. Did you have any discussion——

A. Are you asking me that question, sir?

Q. Yes. Was it around \$100,000?

A. I think the taxes paid——

Q. Well, the return shows it. I will withdraw the question. The return shows the tax.

Did you have any discussion with George or Edward Ferrari—Withdraw the question.

When was your first discussion with George and Edward Ferrari with reference to the fact that they should get a loan to pay the estate tax?

A. I couldn't tell you when that first came up, but I can [151] tell you that within six months after the date of death of Mr. Ferrari, I told them that they had to go out and make arrangements to secure some money to pay the taxes. We discussed over and over, off and on—I don't say within six months, but I do say that over the period of the administration, we discussed selling properties, borrowing on the properties and trying to secure the money under an unsecured note. Eventually the money was secured from the bank on an unsecured note.



(Testimony of Lloyd J. Cosgrove.)

Q. All right. Then in December or October of 1947, when this return was made out and left with Mr. Doyle and you advised the executors that the tax was in the neighborhood of \$100,000, at that time was there any discussion as to when that should be paid?

A. I have no recollection as to me saying when it had to be paid, other than the fact that I told them that it had to be paid with the filing of the return, and if they didn't get it, they would have to pay interest on it.

Q. Did you urge them to attempt to get a loan at that time to pay the taxes?

A. No, I didn't urge them to do anything.

Q. Did they ask you at that time as to the advisability of getting a loan to pay the taxes?

A. They might have, but I have no recollection at this time. [152]

Q. When was the subject of the payment of the tax, when did that next come up after December of 1947?

A. From December of 1947 up to the time it was paid, it came up at different and various occasions.

Q. How many times, sir?

A. Oh, I don't know; half a dozen or a dozen.

Q. Half a dozen or a dozen times? A. Yes.

Q. And were the conversations in general along the same lines in all instances?

A. I would say they were. I have no independent recollection of the conversations, but I would say

(Testimony of Lloyd J. Cosgrove.)

they would be the normal things to discuss and in the normal thing would be along the same lines.

Q. What was the general tenor of those conversations with reference to payment of the tax?

A. The general tenor is that as long as the tax is not paid, they are paying interest on that money at six per cent.

Q. You told them it was six per cent, sir?

A. Yes.

Q. And that was the extent of the conversation on those inquiries?

A. Well, I have no recollection of the conversations, but I say that is—that was the major part of the conversations and the point that was of most interest to all of us was the [153] getting of that money, raising of the money to pay the taxes. Now we had other conversation, many conversations, such as accompany an attorney and client relationship, that they would have in the administration of an estate of half a million dollars. We don't only talk on one subject, you talk on various subjects. And it is all in line with your duty as an attorney representing the executors.

Q. Well, of course I am not asking you, Mr. Cosgrove, for all your conversations with reference to the estate, but merely with reference to the payment of tax. Now you indicate that on half a dozen or a dozen occasions you had a conversation about it and the general tenor of those conversations in every situation was that they would have

(Testimony of Lloyd J. Cosgrove.)

to pay the tax some time, in the meantime they are paying six per cent interest, is that correct?

A. That is the general tenor of the conversations.

Q. Was there anything in particular which prompted them to get a loan in 1949 to pay these taxes?

A. What prompted them to get a loan?

Q. Yes, sir.

A. I don't know what was in their mind, but I can say I urged them to go out and get the loan at that time.

Q. At that time?

A. Because I knew their financial position was sound, I knew that, I was reasonably sure that in view of the fact that they [154] didn't want to put a mortgage on the property, nor did they want to sell a parcel of property. I felt at that time their credit would stand a loan, and we went and talked to the Bank of America and asked the bank if they would give us an unsecured note or loan for the amount and the bank came back in a few days, a few days later, and said it was all right.

Q. Was their credit also sound in December of 1947?

A. No, they had—I'd say it was very sound at all times. Whether or not it was sound for financial institutions to grant a loan of \$90,000 is a matter of opinion. At that time there was expenses involved, there was debts of the decedent, and we didn't know the extent of what they may be. In

(Testimony of Lloyd J. Cosgrove.)

my opinion, their chances were not as good to get a loan, an unsecured loan of \$90,000, in December as it was a year and a half later.

Q. Did you urge them at any time to attempt to get a bank loan prior to April of 1949?

A. Yes, many times we discussed it?

Q. I say did you urge them, sir?

A. What do you mean by urging?

Q. Did you suggest they do it?

A. I suggested that they do it.

Q. Did they ever do it?

A. I might qualify that word suggest. I told them the means of getting it would be to get a mortgage on the property. [155]

Q. Did they ever tell you——

A. I didn't urge them to get a mortgage at any time.

Q. Did they tell you at any time prior to April of 1949 that they had attempted to get a bank loan?

A. I don't recall any conversation on that subject.

Mr. Gillard: I have no further questions.

#### Redirect Examination

Q. (By Mr. Howard): Just one question, Mr. Cosgrove. The return in the Ferrari estate the government has offered in evidence indicates that the tax liability is \$101,031.31.

A. That is right.

Q. Now as I recall your testimony, you testified that at the time this tax was paid, you paid the interest on it to the date of the payment, is

(Testimony of Lloyd J. Cosgrove.)

that correct? A. That is right, sir.

Q. Do you recall how much that——

A. The interest?

Q. Do you recall how much the total amount of money was?

Mr. Gillard: Is this it, in the complaint?

A. I think it was around \$110,000.

Mr. Howard: No, just talking about the interest on the tax. I don't think the complaint makes reference to the interest.

A. (Continuing) There were two checks prepared on this same date, one in the amount of \$101,031.31 and the other one was [156] in the neighborhood of \$8,000 to \$10,000. I think that check is here as an exhibit, I am not sure.

Q. (By Mr. Howard): So that the total amount of money paid at that time included both the tax and the interest, is that correct?

A. Right up to date.

Mr. Howard: I have no further questions.

The Witness: Pardon me. I was going to say, subsequently on audit, this tax, the tax liability was increased and naturally with the increase, Ferrari estate paid the increased tax liability plus interest on that.

Mr. Howard: No further questions, your Honor.

The Court: Is that all? That is all, is it, Mr. Gillard?

Mr. Gillard: That is all of this witness, yes, sir.

The Court: You may step down.

(Witness excused.)



The Court: Gentlemen, I am going to take up some criminal cases, and then we will resume this. You have two witnesses in the Ferrari case?

Mr. Howard: Yes, your Honor, just two witnesses.

The Court: Well, then, we will reconvene—I want to take a little recess and hear these two criminal cases—at 20 minutes past 11.

(Recess.)

Mr. Howard: Your Honor, Mr. Gillard has indicated he was [157] willing to stipulate that if Mr. Cosgrove were recalled to the stand, that he would testify that in 1932 or thereabouts, he tried a case before the United States Board of Tax Appeals, and at that time, at least, he had a treasury card to practice before the Treasury Department.

Mr. Gillard: As I recall, that was the only case he had tried before the Board of Tax Appeals.

Mr. Howard: That is correct.

Mr. Gillard: So stipulated.

The Court: Very well.

Mr. Howard: George Ferrari, would you take the stand, please?

### GEORGE FERRARI

called as a witness on behalf of the plaintiffs, was duly sworn and testified as follows:

The Clerk: Please state your name to the Court, sir.

The Witness: George Ferrari.

(Testimony of George Ferrari.)

Direct Examination

Q. (By Mr. Howard): Mr. Ferrari, you are one of the plaintiffs in this proceeding, is that correct?

A. Yes.

Q. You are the son of Luigi Ferrari?

A. That's right.

Q. Who died in San Francisco on April 2nd, 1946—August 2nd, 1946, is that correct? [158]

A. Yes, sir.

Q. Where were you born?

A. Born in San Francisco.

Q. And when? A. December 23, 1912.

Q. And were you educated in this city?

A. Yes, sir.

Q. And did you go to grammar school here?

A. Yes, sir.

Q. And where did you go to grammar school?

A. Saint Charles Parochial School in the Mission District.

Q. And did you go to high school?

A. Yes, sir.

Q. Where did you go to high school?

A. Galileo High School.

Q. Did you graduate from high school?

A. Yes, sir.

Q. Did you have any education beyond that time? A. No, sir.

Q. Now, Mr. Ferrari, at the time your father died in 1946, what business were you engaged in?

A. In the wholesale produce business.

Q. And was that your father's business?

(Testimony of George Ferrari.)

A. Yes, sir.

Q. And how long had you worked in the business at that time? [159]

A. Oh, I started in 1933.

Q. And what were your duties in connection with the business?

A. Well, it would be buying produce and getting to market in the early morning, and we would do our own work. We worked all day, delivering produce and—Well, we would just deliver it, and my father and my brother and I all worked together.

Q. And how many employees were engaged in the operation of this business?

A. Well, we had no employees. We did it ourselves.

Q. And by "ourselves," who do you mean?

A. My dad and my brothers, that's all.

Q. How many brothers did you have at that time?

A. There was two brothers and myself and my dad.

Q. And you did all the work in connection with the business?

A. Everything, yes.

Q. Now did you have any employment prior to the time that you went to work in your father's business?

A. Well, I sold newspapers.

Q. And when did you start selling newspapers?

A. When I was about five years old.

Q. In San Francisco?

A. Yes, I sold them out on Seventh and Mission here, outside the federal building.

(Testimony of George Ferrari.)

Q. And you sold newspapers up to the time you went to work [160] for your father?

A. Well, I quit selling papers just before I went to high school. Then when I went to high school, I would help my father out during vacation and Saturdays and stuff like that.

Q. Now you have no education beyond your high school education, is that correct? A. No, sir.

Q. Did you ever go to business school?

A. No.

Q. Now how long have you known Lloyd Cosgrove, Mr. Ferrari?

A. Well, I met him when I was working for my dad out in the Mission District. I was introduced to him one day, my dad said he was the——

The Court: He just wants to know when it was.

A. Well, I guess it must have been prior, probably 1933, '34 or '35, around that time, I guess.

Q. (By Mr. Howard): And at the time that your father died in 1946, then you had known Mr. Cosgrove ten or twelve years, is that it?

A. Yes, that's right.

Q. Now you were named in your father's last will and testament as a co-executor of the estate, is that correct? A. That's right.

Q. And when did you first find that out?

A. Well, Mr. Cosgrove—we went to his office and he said, [161] “You fellows are the executors.” That's all. And he read the will out.

Q. When did that occur?

A. After my father passed away.

(Testimony of George Ferrari.)

Q. How soon after your father passed away?

A. I couldn't say. Maybe it might be two days, three days, one day, might have been a week. I really don't know.

Q. It was a few days after your father died, is that correct?      A. That's right.

Q. Now at that time did you have any discussion with Mr. Cosgrove about the administration of your father's estate?

A. Yes, I didn't know, first time I ever heard of executors so I didn't know what the job was. So he just told us that he would handle the estate and then he would tell us from time to time what to give him and we would bring down to him, like deeds and insurance papers and leases on the property and anything we can find of any value to the estate.

Q. And from time to time he made requests of you for various documents?      A. Yes.

Q. And deeds and so on, in connection with the estate?      A. That's right.

Q. Now at that time that you were appointed executors of the estate, did you have any familiarity with the duties of an executor other than what Mr. Cosgrove told you? [162]

A. No, none whatsoever, no.

Q. You had never been an executor prior to that time?

A. No, I didn't know what it was, myself.

Q. And you never had any—did you have any connection with the probate of any other estate



(Testimony of George Ferrari.)

prior to that time?      A. No, nothing.

Q. Now, Mr. Ferrari, getting down to the substance of this proceeding, when did Mr.—when did you first become aware of the liability of the estate for federal estate taxes?

A. Some time in 1947.

Q. And about what time was that?

A. Well, it was a little after a year after my father passed away, around the holidays, sometime around the end of 1947.

Q. And how do you fix that time in your mind?

A. Well, he certainly never had much time in the estate at that time, and he—there was a few things that he wanted from our accountant at the time and we had brought him in and he was even rushing him at the time. It was near the end of the year.

Q. Did he call you into his office?      A. Yes.

Q. And did he explain why he called you into his office?

A. Well, he said he never had much time on the estate, his time was almost up, and he told us about the liability, the tax would be about \$100,000. [163]

Q. And at that time did he tell you about a federal estate tax return?

A. Well, he mentioned something pertaining to that fact, about estate taxes.

Q. And you recall at that time signing any document?      A. Yes.

Q. Was it represented to you as an estate tax return?

(Testimony of George Ferrari.)

A. It was something to that effect, he says estate tax papers.

Q. Now, Mr. Ferrari, I show you here a document which is in evidence in this proceeding as Defendant's Exhibit D, which purports to be the estate tax return of the estate of Luigi Ferrari, and I ask you if you have ever seen that document.

A. Oh, it is something like this here.

Q. You saw something like this?

A. Yes, sir.

Q. When was the first time to your recollection you saw that?

A. It was sometime in 1947.

Q. I see.

Mr. Howard: If your Honor please, I intended to refer to Defendant's Exhibit A, which is a photostat copy of the original return filed in the estate.

The Court: All right.

Q. (By Mr. Howard): Now I show you this document, Mr. Ferrari, [164] which is Defendant's Exhibit A, which is a photostatic copy of a federal estate tax return, and I ask you if you had seen the original of that document, would your answer be the same as with respect to the return I showed you a minute ago? A. I think so.

The Court: Well, he signed it, did he not?

Mr. Howard: What's that?

The Court: He signed it.

Q. (By Mr. Howard): Now calling your attention, Mr. Ferrari, to sheet 21 of this document, is that your signature on there?

(Testimony of George Ferrari.)

A. That is my signature.

Q. George Ferrari? A. That's right.

Q. And do you recall when you signed that document?

A. Some time in '47 near the end of the year, like I told you.

Q. This document indicates it was signed on the 31st day of October, 1947. Would that be about the time you signed it to the best of your recollection?

A. The best of my recollection, it would be, yes, sir.

Q. Now you testified that at that time you had a conversation with Mr. Cosgrove relating to this return and the amount of tax that was involved, is that correct? A. That's right.

Q. And what did he tell you about the amount of tax involved?

A. He says about \$100,000. We told him what the tax was, [165] he told us it was about \$100,000. And "Gee," I said, "Holy—what was the—never thought it would be so much money," I said. "There's no money in the estate to pay that kind of tax," I told him. And then he talked about, he was going to get an extension of the time, he said, and then when we, probably when we, after we borrowed the money, we would pay the tax and we would have to pay six percent interest. He went along those lines there.

Q. And now, Mr. Ferrari, in this return there is a Schedule K, debts of the decedent, which I call to your attention, and you will note the first item

(Testimony of George Ferrari.)

there is federal income tax, \$9100. A. Yes.

Q. Do you recall the payment of that?

A. Well, I thing that is the time the accountant was—Cosgrove was always pushing him about he wanted the debts on the federal income tax. I know the accountant at the time was working, figuring up what the tax liability was to give to Cosgrove.

Q. Now I call your attention to the other items on this Schedule K, debts of the decedent, and ask you if you as the executor of the estate paid those items that are listed there. A. That's right.

Q. And they total \$24,983.96, is that correct?

A. Yes. I don't know what the total is, but I know we paid them out. [166]

Q. Now I call your attention to Schedule J, funeral and administration expenses.

A. M-hm.

Q. You see there, there is executors' commission of \$3600. A. M-hm.

Q. Attorney's fees of \$4600. A. Yes.

Q. Funeral expense of \$2,000. A. Yes.

Q. Cemetery of \$1700. A. Yes.

Q. And that column totals \$13,757.02.

A. Yes.

Q. Now did you pay those obligations as the executor of the estate?

A. Yes, had to pay everything.

Q. Now, Mr. Ferrari, do you recall any conversation with Mr. Cosgrove with reference to the inventory and appraisement of the estate?

A. What do you mean?

(Testimony of George Ferrari.)

Q. A document in which the valuations of the properties were set forth?

A. Well, he gave us the appraisal prices.

Q. And when did that occur?

A. After we had signed that estate tax papers there. [167]

Q. Now how long after?

A. I don't know. Might have been—Who knows? Might have been—I wouldn't say. May be a week, two, three, four, five, six, seven; I don't know.

Q. I see. A. I wouldn't know.

Q. Would it be in the early part of 1948?

A. It could probably have been '48.

Q. And did you have a discussion with Mr. Cosgrove about those valuations?

A. Yes. Gee whiz, I thought they were kind of high, those there. So there was one piece of property there that I thought that was too high, so I told Mr. Cosgrove about it and he says, well, there's nothing he can do about it, "But if you can get somebody who is a competent real estate man, like the man who has been collecting your rents, like Madison and Burke," they manage the property, and he said, "If you get somebody down there to talk to the appraiser, and maybe if they can do anything, they will do something for you." And then I told him, it was too late to do anything like that, and he says, "No, you can still make the change," he said he can still make the changes. So I had Mr. Dempsey of Madison and Burke contact the fellow who was the appraiser and then they—



(Testimony of George Ferrari.)

well, I don't know what took place, but there was one piece they did get the value down on about \$20,000. [168]

Q. Who was the appraiser at that time?

A. Green.

Q. Mr. Breen?

A. Something like that—Breen or Green. I think it was Breen.

Q. Breen, yes. Now you contacted Mr. Dempsey, was that it?

A. Yes. He is the boss down at Madison and Burke.

The Court: I don't see the materiality of going into this matter.

Q. (By Mr. Howard): Mr. Ferrari, now at the time Mr. Cosgrove informed you of the amount of tax that would be involved, federal estate tax that would be involved in this estate, did you discuss the matter of the payment of it?

A. Well, we talked about it, but there was no money in the estate at the time, so what he said, "You will have to—all these outstanding bills, you just keep paying them off and then when there is a little money in the estate, we can go to the bank and try and get a loan from the bank," he says, and which we did in 1949.

Q. Did he tell you about when the tax had to be paid at that time?

A. There was no mention of when I had signed the estate tax papers at the time.

Q. Did he say anything to you about interest?

(Testimony of George Ferrari.)

A. Yes, he mentioned interest, yes. [169]

Q. What did he say about it?

A. Well, he said, "It will cost you six percent interest," he says, "when you pay the tax." He mentioned something like around one half of one percent or—which was six percent, he said. He says, "When you pay the tax," he says, "you will have to pay six percent interest." I said that was all right.

Q. And now what did you do about raising money to pay the taxes then?

A. Well, there was so many bills to pay, I mean there was a lot of money got to be paid out, and so we just, every month when the—well, when the rent moneys come in, we had a special account in the bank, see, that everything that came in was deposited in the Bank of America, through a special account in the bank that was the estate account. And all the money went to the estate account and then when there was, then as the bills come in, we would pay off the different bills.

The Court: There weren't any mortgages on these, this estate?

The Witness: What's that, your Honor?

The Court: There were no mortgages?

The Witness: Oh, yes, there was about \$50,000.

The Court: In mortgages on some of the parcels?

The Witness: Yes, that's right, Judge, your Honor.

Q. (By Mr. Howard): Well, now, did you discuss with Mr. [170] Cosgrove obtaining a bank loan on the property?

(Testimony of George Ferrari.)

A. We discussed about it.

Q. When did these discussions take place?

A. Well, the first time we talked, I think,— I don't remember now. I know we discussed about when he had told us about the tax being about \$100,000, and I don't know whether we discussed about that before or not. We probably did. But the main time was in 1947, we discussed. We owed a lot of money. I mean, there was no possible way that you can probably raise that money there. So when he had said that we would build up the estate fund and when the time comes to make an arrangement for a loan, then we would go to the bank and borrow the money to pay off the tax with the six percent interest.

The Court: You didn't make any independent efforts to borrow this money; you relied on what Attorney Cosgrove told you as to the difficulty of getting money at that time?

The Witness: I think so. I didn't quite——

The Court: Well, I will ask it a little more simply. You yourself did not attempt to get any money, borrow any money from the bank until 1949, is that right?

The Witness: That's right.

The Court: You were relying upon Cosgrove's statement that it would be difficult to get the money, borrow any money until the estate had proceeded further, had got more [171] money into the estate?

The Witness: Yes. Well, he had told us in '47.

The Court: Well, I know, but it is because you

(Testimony of George Ferrari.)

relied on what he told you in that regard that you didn't make any efforts to actually make a loan from the bank until '49?

The Witness: Well, I think so.

Q. (By Mr. Howard): Well, now, Mr. Ferrari, when did you first become aware of the fact that the federal estate tax return was due fifteen months after the day of your father's death?

A. That was 1948.

Q. What time in 1948?

A. Some time in 1948. I couldn't place the exact date.

Q. And how did that come about?

A. Well, my neighbor, I had my neighbor next door, we used to go over and talk and he had a pool table in his basement, and——

The Court: Well, do we have to go into all the details? Can't he say how he found out? Somebody told you that?

The Witness: Yes.

The Court: Who was it told you?

The Witness: My neighbor next door. He found, he got me an estate tax return and that's my—seeing it there,——

The Court: That is the first time; it was because some neighbor told you in '48, that was the first time you say you [172] became aware that the return had to be filed in fifteen months?

The Witness: That's right.

The Court: Is that correct?

The Witness: Yes.

(Testimony of George Ferrari.)

The Court: Cosgrove never told you that?

The Witness: Not in '47. I found out in '48 about it.

The Court: All right.

Q. (By Mr. Howard): Now Mr. Demartini—was that his name? A. That's right.

Q. And did he get a federal estate tax return for you? A. Yes.

Q. And did you look at it then? A. Yes.

Q. Was that the first time you were aware of the fact that the return was due in fifteen months?

The Court: He just said it was.

Q. (By Mr. Howard): Now what did you do then, Mr. Ferrari?

A. Well, I went back to Mr. Cosgrove's office and I told him about it, it says here about fifteen months and he never told me about fifteen months, I told him. And then he wanted to tell me, he knew all about the fifteen months. He says, "You didn't have the money to pay at the time. There was no money to pay the tax. But when you do pay," he says, "you will pay six percent interest when you pay the tax." That's [173] all I wanted to know. He never told me before.

Q. Now, Mr. Ferrari, did Mr. Cosgrove tell you that he had filed a federal estate tax return?

A. He told me. He did tell me.

Q. When did he tell you that?

A. When I went back and told him about the fifteen months, that's when he mentioned that he had a return on file.



(Testimony of George Ferrari.)

Mr. Gillard: He had what? May I have that answer, Mr. Reporter?

(Record read.)

Q. (By Mr. Howard): Now, Mr. Ferrari, when did you first become aware of the fact that there were possible penalties involved in this situation?

A. Well, I went to see another attorney in 1949—his name was Harry Baier—and he told me there might be a penalty.

Q. How did you happen to go see Mr. Baier?

A. Well, this neighbor of mine, you see, his father-in-law, Mr. Baier worked on his estate.

The Court: Is that material? This is a case to recover a refund on the tax. Can't you just develop the simple fact that he did go to another attorney? How he went there is immaterial. What do you want to bring out, what the attorney told him?

Mr. Howard: No, I was just trying to bring out that Mr. Ferrari—what his knowledge of this situation was and [174] how he first became aware of this situation.

The Court: Well, he first became aware of it, he has already told us that; now you want to develop that some attorney told him about the penalties. Why don't you just ask him the direct question to save time? Some attorney by the name of Baier you went to in what year, 1949?

The Witness: '49.

The Court: And do you know when that was?

The Witness: Around March, I guess.

The Court: And what did he tell you?

(Testimony of George Ferrari.)

The Witness: He said there might be a penalty on the estate.

The Court: All right.

Q. (By Mr. Howard): Then what happened?

The Court: That is the first time you knew about the penalty?

The Witness: Correct.

The Court: All right.

Q. (By Mr. Howard): Then what did you do?

A. I went back and told Mr. Cosgrove and Mr. Cosgrove said, "There will be no penalty." That's all. I told Cosgrove, he said there would be no penalty.

Q. Did he explain why?

A. He just said, "There will be no penalty." Says, "Everything is all right," he said to me. [175]

Mr. Howard: I see. I have no further questions.

The Court: Mr. Gillard, did you have in mind any extensive cross-examination? I am just trying to regulate the time element involved.

Mr. Gillard: It will be a lot longer than fifteen minutes, if that is the question.

The Court: Well, I thought maybe we had— Then you have one other witness?

Mr. Howard: Mr. Ferrari's brother, the other co-executor.

The Court: Will it be about the same tenor?

Mr. Howard: Same general testimony. His testimony shouldn't be as long, because——

The Court: All right. Then that would conclude the testimony?

(Testimony of George Ferrari.)

Mr. Howard: Yes.

The Court: You were planning to make some oral presentation in the case, oral argument?

Mr. Howard: Well, I just plan to make a very brief oral presentation. I have prepared a trial memorandum for you, your Honor.

The Court: Well, then, I would suggest that we recess until 1:30.

Mr. Gillard: Let me ask the witness just two preliminary questions,—

The Court: All right. [176]

Mr. Gillard: If the Court please, it may control what I want to do over the lunch hour.

### Cross Examination

Q. (By Mr. Gillard): Mr. Ferrari, as I understand your testimony, you signed some kind of a tax return in 1947, is that correct?

A. That's correct.

Q. You know that was an estate tax return?

A. Well, it was a federal estate tax paper or something similar to federal estate tax return.

Q. Well, this Exhibit B, estate tax preliminary notice, is an estate tax paper, Mr. Ferrari. Is that what you have in mind as having been signed?

A. No, I remember signing that too.

Q. And you have a recollection, then, sir, of signing an estate tax return in 1947, is that correct?

A. Yes, sir, correct.

Q. Now did you ever thereafter sign any other estate tax return?

(Testimony of George Ferrari.)

A. I don't have no recollection.

Q. Did Mr. Baier prepare an estate tax return at your request?

A. Well, not at my request. I told him to.

Q. Well, did he prepare a return,—Mr. Baier?

A. He prepared a return.

Q. Yes. And you saw the return he had prepared? [177]

The Court: He has already testified he did.

Q. (By Mr. Gillard): You saw that return, sir? A. Yes.

Q. Didn't you sign that return?

A. No, I never signed that return.

Q. Did you ever tell Mr. Baier you'd signed that return?

A. I told Mr. Baier I never signed it.

Q. You told Mr. Baier you would never sign it?

A. That's correct.

Q. Did you ever tell Mr. Baier that you had signed it? A. No, I never told him that.

Q. Well, now, Mr. Ferrari, when you are referring to a return,—

Mr. Gillard: This is not—

The Court: Well, you may want to pursue this further. I think perhaps we might recess now until 1:30.

Mr. Gillard: Well, at this time, if Your Honor please I will file the memorandum for the government that you asked about last week.

The Court: Have you got a memorandum too, counsel?

(Testimony of George Ferrari.)

Mr. Howard: Yes.

The Court: I wonder if you would just let me have it now so I may look at it while I am eating lunch. [178]

(Document passed up to Court)

(Whereupon a recess was taken until 1:30 o'clock)

1:30 O'clock, Afternoon Session

Q. (By Mr. Gillard): Mr. Ferrari, at the time that you first contacted Mr. Cosgrove with reference to the estate of your father, did you make any inquiry of him as to his abilities with reference to federal estate tax matters?

A. No, I just, we went to him, my father passed away and, well I mean, there was—Well, you see, we live in the Mission District and Cosgrove—

The Court: Well, all he wants to know is whether you made inquiry on that subject.

A. No, I didn't.

Q. (By Mr. Gillard): Now there came a time, I gather, when in the course of the administration of the estate, that you went to Mr. Cosgrove's office and you signed some estate tax papers, is that correct?

A. That is correct.

Q. And that was to the best of your recollection in the fall of 1947?

A. Yes, that's right.

Q. You were shown Exhibit A a little while ago, the estate tax return, with your signature on it, and the date preceding that signature is October 31, 1947. Did you sign the return on that date?

A. Around that time. [179]



(Testimony of George Ferrari.)

Q. Around that time? A. Yes, sir.

Q. Well, at that time, as I recall, you said——

The Court: That is the return that was filed in April '49?

Mr. Gillard: That is correct, Your Honor.

Q. (By Mr. Gillard): That's the return that you were shown, the return that was filed in April of '49, is that correct?

The Court: Well, it shows on its face that it was filed,——

Mr. Gillard: Oh.

The Court: ——in 1949.

Q. (By Mr. Gillard): At that time, at the time that you signed your name to an estate tax paper of some kind, did you also sign this estate tax preliminary notice, Exhibit B?

A. No, I don't remember. I can't remember. I did sign this here, I think it was before we signed those papers there.

Q. You think you signed this preliminary notice before you signed an estate tax return?

A. I think so.

Q. Are you sure of that, Mr. Ferrari?

A. Well, to the best of my recollection. It was around that time there, but if it was the same day, I wouldn't remember.

Q. Do you recall that you testified in a criminal proceeding, in a criminal action against Paul V. Doyle and Lloyd J. Cosgrove? [180]

A. M-hm.

Q. And you testified in that case in June of

(Testimony of George Ferrari.)

1952? A. I guess it was around that time.

Q. Do you recall this testimony at that time, Mr. Ferrari:

“Q. I show you now Government’s Exhibit Number 1 and ask you if you can identify the signature George Ferrari and Edwards Ferrari that appear on there. “A. Yes, I remember this.

“Q. Now when did you sign that, Mr. Ferrari?

“A. It was about the same time, I think.

“Q. Was it on the same day?

“A. I am pretty sure it was. I remember seeing at the same time this \$400,000, just kind of drew my attention, see \$400,000. And that is why I remember this here.”

Do you remember that testimony, Mr. Ferrari?

A. I—Well, I kind of remember it a little bit, when I testified at the trial.

Q. And the \$400,00 you are referring to——

A. Yes.

Q. ——was the \$400,000 stated on this Exhibit B as being the amount of the gross estate?

A. Yes, that’s right, I think that’s right, I think it is. Well, it was around that time. It was around that time, like I just explained to you. [181]

The Court: Was there a date on it, is there a date on this?

Mr. Gillard: I don’t believe there is a date on that, no, sir.

The Witness: Whether it was the same day or——

Q. (By Mr. Gillard): “Q. Your recollection is, then, that you signed Government’s Exhibit

(Testimony of George Ferrari.)

Number 1, the preliminary notice, at the same time you signed Government's Exhibit Number 2, the estate tax return?        "A. I think I did."

Is that the truth of the situation, Mr. Ferrari?

A. I think it was around the same time.

Q. The same day?

A. Well, I wouldn't say the same day, but around that time.

Q. Now at the same time was there a discussion about an extension of time?

A. There was, yes.

Q. What was the discussion with reference to that?

A. Well, Mr. Cosgrove said at that time he didn't have much time left on the estate and his time was almost up and then he mentioned about the tax being around a hundred thousand dollars and that's when we said there was no money in the estate to pay the tax at the time, because there was so much money owing out. And then he did mention [182] about he was going to get an extension at that time, where, as we had paid the tax later, we would pay six percent interest.

Q. Now when he talked about getting an extension of time, what kind of extension of time were you talking about?        A. On the payment of tax.

Q. An extension of time to pay the tax?

A. Yes.

Q. You weren't talking about an extension of time to file the return?

(Testimony of George Ferrari.)

A. Well, I didn't—It didn't occur to me at the moment about the return.

The Court: Well, did he ever tell you that he got an extension of time?

The Witness: Well, he did mention he was getting an extension.

The Court: No, that is not what I asked you. Did he tell you that he had gotten an extension of time for you?

The Witness: That I don't remember.

The Court: You don't remember whether he told you?

The Witness: Well, I thought——

The Court: Do you remember how much time you were talking about that he was going to get an extension for?

The Witness: He didn't mention no time limit; just says get an extension.

The Court: Get an extension; but as far as [183] you know, you don't remember whether he ever told you whether you got an extension?

The Witness: Well, I just went by what he told me.

The Court: Did you ever ask him whether he got the extension later on?

The Witness: No, I just said that one time there that I told him in '47 when he said he was getting an extension. That's all there was to it. I never told him any more.

The Court: Well, then, let's get your answer clear so there is no question about it. You never

(Testimony of George Ferrari.)

asked him thereafter and he never thereafter told you whether he did get an extension or not?

The Witness: That's right.

Q. (By Mr. Gillard): Now at the time you signed this form in front of you, this Exhibit B, you read that before you signed it, did you, Mr. Ferrari? A. No, I didn't read it.

Q. You glanced at it? A. That's right.

Q. You glanced at it and you saw the \$400,000 figure? A. That's correct.

Q. Did you also see the bold face print printing at the bottom of the form right under your signature? A. No.

Q. Will you read that, please, the bold [184] face printing at the bottom of the page? Would you read it out loud?

A. "Failure to file the required return on Form 706 within fifteen months from date of the death may render executors, administrators and persons in actual or constructive possession of the decedent's property liable for penalties."

Now I didn't even see that.

Q. Didn't see that, sir? A. No, sir.

Q. Now When Mr. Cosgrove told you the tax was going to be in the nature of a hundred thousand dollars, you thought that was pretty high, did you?

A. Well, I thought it was pretty high.

Q. And did you want at that time to get some other help from some other tax attorney or some other specialist to see if that tax could be cut down?



(Testimony of George Ferrari.)

A. Not at that time.

Q. Not at that time? Why not?

A. Well, I didn't know nothing about those there things at that time.

Q. You knew the tax was going to be \$100,000?

A. Yes.

Q. You weren't concerned at that time about the amount of \$100,000, is that correct?

A. Well, it was—it come so quick that he [185] told us just out of a blue sky and it almost knocked us over for a loop. And he said he'd have to have these estate tax papers in, he said, his time was running short and he says the taxes is \$100,000, and we couldn't dig up any money at a moment's notice to pay the taxes in the short time.

Q. Eventually there was another tax return prepared by the accounting firm of Prior and McClellan, is that correct?      A. I think so.

Q. And you were shown that return, were you not?

A. Well, I don't remember. There was — I don't remember the time.

Q. Do you remember you saw a return prepared by Prior and McClellan?

A. Well, Cosgrove mentioned something about Prior and McClellan, but I didn't know the people, though.

Q. When did you go to seek advice yourself about trying to get some return prepared which would show less than a hundred thousand dollars?

A. Oh, I just—Mr. Cosgrove told me——

(Testimony of George Ferrari.)

The Court: No, he just asked you when it was that you did that.

A. Oh, I think——

The Court: See, it is very hard to follow you if you don't answer the question. You can explain them afterwards, but you talk about something else in answer to the question. [186]

A. I think it was 1949.

Q. (By Mr. Gillard): 1949. So that the first time you took any action at all on your part to try to have this estate tax reviewed and see if it was possible to get a lesser tax was in 1949?

A. That's right.

Q. Now, sir, I will hand you Defendant's Exhibit E and ask you if you ever saw the original or a copy of that letter before.

A. No, I never seen this letter there.

Q. Did Mr. Cosgrove ever tell you that he had received a communication from the Internal Revenue Department asking where the return was?

A. No.

Q. What is the date of that letter, sir?

A. October 22, 1948.

Q. Isn't October, 1948 approximately the time you saw Mr. Demartini?

A. I wouldn't remember. It was some time in 1948.

Q. Are you able to say, sir, that you did not see Mr. Demartini around October of 1948?

A. I wouldn't say it was October, '48.

Q. It could have been?

(Testimony of George Ferrari.)

A. It might have been, but I am not—I don't remember.

Q. It could have been any time in 1948 up [187] to and including October, is that correct?

A. It could be.

Q. And at that time Mr. Demartini told you something about the fact that a return was due to be filed in fifteen months after your father's death, is that correct?      A. No.

Q. What did he tell you, sir?

A. Well, we talked, just talked about the taxes, that's all. I told him that my father's estate, I said the taxes are about a hundred thousand dollars, I told him, and he says, and then I told him that we were paying interest when we pay the taxes, I told him. And so he told me that he had an estate tax return upstairs in his room, he had from his father's—his father-in-law's estate. So then he told me if I wanted, if he wanted to get me one. I says, "It's all right," I says, "Go ahead," I told him.

Q. Didn't you discuss with him at the time the time when the return was supposed to be filed?

A. No.

The Court: I thought you said a little while ago when your own attorney was examining you that that was the first time that you learned that an estate tax return had to be filed within fifteen months.

The Witness: When he got me the return, I seen it on there. He didn't tell me. [188]

(Testimony of George Ferrari.)

The Court: Well, it was as a result of your discussion?

The Witness: Yes, he got me an estate tax return.

The Court: So you looked at it and you saw it had to be filed within fifteen months?

The Witness: Filed and tax paid within fifteen months, that's right.

The Court: All right.

Q. (By Mr. Gillard): So at that point, then, you saw on that return there was a requirement it had to be filed within fifteen months after death?

A. That's right.

Q. And then you went to Mr. Cosgrove and asked him whether or not you didn't have to file a return within fifteen months. is that correct?

A. Who?

Q. You went to Mr. Cosgrove then to ask him about this fifteen months business?

A. No, I told Cosgrove, he never told me about the fifteen months. That's all.

Q. Did you ask Mr. Cosgrove whether a return had been filed?

A. He told me he had a return on file.

Q. This was after you had this conversation with Mr. Demartini?

A. Yes, that's right, yes.

Q. And that was the first time you knew [189] anything about whether a return had or had not been filed?

(Testimony of George Ferrari.)

A. Return filed and about the payment of the tax that's right.

Q. Will you answer my question, please, sir?

Mr. Gillard: Would you read the question back, Mr. Reporter?

(Record read)

A. Well, I knew I had signed the return that this Demartini gave me, I had remembered I had signed the similar paper in 1947 in Mr. Cosgrove's office.

The Court: Are you sure that you signed an income tax estate return in October, 1947?

The Witness: Something similar to the one I seen.

The Court: Are you sure you signed it, now?

The Witness: Well to my best recollection, that's as far as I can remember. This is when Cosgrove, he told, said to sign the estate tax papers, and I just took it for granted, that's all.

The Court: Well, go ahead, counsel.

Q. (By Mr. Gillard): Now as a matter of fact, when you went to see Mr. Cosgrove on that occasion, Mr. Cosgrove told you that he had the return on file?

A. He says, "I have a return on file," he said.

Q. "I have the return on file?"

A. He says, "I have a return on file." [190]

Q. "I have a return on file?"

A. That's correct.

Q. And is that what you testified to in the last trial, the criminal trial?



(Testimony of George Ferrari.)

A. I don't remember.

The Court: Well, you can't ask him that. Read it to him.

Q. (By Mr. Gillard): Do you remember this testimony? Oh, one further prior question. Did you ever at any other time discuss with Mr. Cosgrove the question of whether or not the return had been filed or whether you should file the return?

The Court: You mean any other time except this?

Mr. Gillard: Except this occasion after the Demartini conversation.

A. That's all I can remember, Mr. Gillard.

Q. (By Mr. Gillard): Now do you recall this testimony in 1952:

"Q. Do you remember what Mr. Baier told him?

"A. Oh, about fifteen months, about the tax being paid fifteen months, and I had already explained to Mr. Baier about that. We were to pay an interest on the taxes, see, and I told him that there was a time, one time when I remember Mr. Cosgrove did tell me that he had to return the file, see, and, but we were to pay the tax and you can always make some changes, see, maybe at a later date. Maybe [191] you can always make a change." Do you recall that testimony, Mr. Ferrari?

A. I am trying to remember it. He did mention that he can make changes on the return.

Q. Yes. And at that same time he told you that he was going to file the return some time, didn't he?

A. File the——?

(Testimony of George Ferrari.)

Q. He was going to file the return?

A. I don't remember him——

Q. He never told you he had filed the return, did he?

A. Said he had one.

Q. Some time prior to October of 1948?

A. Well, on that discussion that time, I had with him, he said he had a return on file. He said he knew all about the fifteen months, he told me. He says, when you haven't got the money to pay the tax, but when you do pay the tax, you will pay it with six per cent interest.

Q. How much interest did you pay the bank for the \$90,000 loan?

A. I guess around about, around \$9,000 or \$10,000, I guess.

Q. How much interest did the loan bear?

The Court: What was the rate of interest?

The Witness: Six per cent.

The Court: To the bank?

The Witness: No, wait, let's see. It was, I think it [192] was five per cent. I think it was five per cent; I am pretty sure.

Q. (By Mr. Gillard): All right. Now as I understand your testimony with reference to the payment of the tax itself, it was your idea to wait until some money had accumulated in the estate and then with that money plus what you could borrow, you would pay for the tax that was due on the estate, is that correct? A. Yes.

Q. Were you then in a better position with reference to the moneys in the estate in April of

(Testimony of George Ferrari.)

1949 than you were in December of 1947?

A. That's right.

Q. You were, sir.

Mr. Gillard: May this be marked for identification, the Superior Court file 104-168?

The Clerk: That's Defendant's Exhibit F marked for identification.

Mr. Gillard: I am referring only to the account of the executors, if the Court please, in that file. I showed you this, didn't I?

Mr. Howard: Yes.

(Whereupon Superior Court file was marked Defendant's Exhibit F for identification.)

Q. (By Mr. Gillard): I am showing you, Mr. Ferrari, the [193] estate file in the estate of Luigi Ferrari, on file with the Clerk of the Superior Court in and for the City and County of San Francisco, File Number 104-168, and referring you therein particularly to the first and final account of executors, which was filed together with your petition for settlement of the first and final account, and for final distribution, on May 16, 1949; and call your attention to the account and the recapitulation on there. Is that the account that you filed at that time?

The Court: Well, obviously it is.

A. I don't know. I don't know about these.

The Court: Ask him some other questions.

A. I don't know nothing about this stuff here.

Q. (By Mr. Gillard): That recapitulation shows, does it not, Mr. Ferrari, that during the

(Testimony of George Ferrari.)

course of your administration of the estate, you collected in cash \$56,122.26 and spent \$113,145.04 for a deficit of \$57,022.98?

A. Well, I guess whatever is there. I don't know much about those things.

Q. Is that what the account shows?

A. If it's right there, I guess. I don't—

Q. And the account shows that the final payment that was made prior to the rendition of the account was a payment made on April 24, 1949?

A. What's that for? [194]

Q. It was to your mother for the family allowance. A. How much?

Q. I didn't say the amount. Was that the final payment made prior to the rendition of the account?

The Court: Does it appear to be on the account?

Mr. Gillard: Yes, your Honor.

The Court: Then I don't think you need to ask.

The Witness: What's that for? My mother collected—You mean this here?

Q. (By Mr. Gillard): Yes, sir.

A. To Rose—

Q. Referring to the last item on the account.

A. I guess so. I don't know nothing about those things there.

Mr. Gillard: I will offer the final account into evidence from that Exhibit, if the Court please.

The Court: Admitted.

(Whereupon final account from Defendant's

(Testimony of George Ferrari.)

Exhibit F for identification was received in evidence.)

The Court: You'd have been better off to have borrowed this money from the bank in 1947. It would have cost you a lot less money; you would have got a lower rate of interest. You would have had the obligation all paid off.

The Witness: There is quite a few bills, there was a lot of money owing, though. I don't know how you could pay the bills off. [195]

The Court: You had a deficit in your account in 1949, and still the bank gave you the money. The obvious reason for that is that a lot of money went out for family allowance and other things. The bank wasn't particularly concerned about that as far as making a loan was concerned.

The Witness: Well, family allowance, I think, was about \$500 a month.

The Court: Well, go ahead.

Mr. Gillard: I think that's all, your Honor.

### Redirect Examination

Q. (By Mr. Howard): Mr. Ferrari, you were engaged in business with your father prior to the time of his death; you testified to that effect?

A. Yes, that's right.

Q. And there was your father and your brother George and a third brother, is that correct?

A. Well, there was Anthony.

Q. Anthony? A. Anthony.

Q. And when did Anthony die?



(Testimony of George Ferrari.)

A. He died November, 1945, about six or seven months before my father died.

Q. I see. So that up to the time of Anthony's death, there were the four of you running the business? A. Yes. [196]

Q. And then when Anthony died, that left three? A. Yes, sir.

Q. And then after your father died, you and your brothers, or your brother George, carried it on?

A. Well, I am George.

Q. I mean your brother Edward and you carried on with the business yourselves? A. Yes.

Q. Now what time did you go to work in the morning?

A. We go to work about 4:30 or 5 in the morning.

Q. And when is your work finished?

A. Oh, in the afternoon around 4 o'clock.

Q. I see. And who drives the trucks in the delivery of the merchandise?

A. My brother. He does most of the heavy work and I do most of the lighter work.

Q. Now, Mr. Ferrari, did you ever know Paul Doyle? A. No.

Q. You knew him at no time involved in this proceeding? A. Huh?

Q. You did not know him at the time?

A. No, I never knew that fellow.

Q. Did you ever personally have any contact with anyone in the Internal Revenue service relat-

(Testimony of George Ferrari.)

ing to your federal estate tax return prior to the time that it was filed? [197]

A. Nobody.

Mr. Howard: No further questions.

The Court: Mr. Ferrari, is your mother living?

The Witness: My mother is pretty sick right now. She has got pneumonia.

The Court: She is still alive?

The Witness: Yes, she is pretty——

The Court: She was the sole heir of the estate?

The Witness: Yes.

The Court: The whole estate went to your mother?

The Witness: That's right. That is why I couldn't understand——

The Court: And she had some property of her own in addition, did she not?

The Witness: Not—my mother had to pay the while thing. She was married fifty-five years to my father, and when my father passed away, my mother had to pay on the whole estate to get the whole thing back again—for fifty-five years.

The Court: Does she have property of her own?

The Witness: Well, I am—I mean she worked and she was supposed to have some property, and they didn't give it nothing. They took it all away from her. I mean, she had nothing. She had to pay on the whole estate.

The Court: I am not quite clear what you mean by that. [198] When your father died, this estate

(Testimony of George Ferrari.)

was appraised at about \$500,000, as I understand, or \$400,000.

The Witness: Yes, that's right, your Honor.

The Court: A lot of real estate, and the business.

The Witness: My father was out of business at the time of his death.

The Court: You boys were—at the time of his death the business belonged to the boys?

The Witness: Just—my father died and my——

The Court: All I am trying to find out is, at the time of your father's death, the business belonged to you and your brother?

The Witness: That's right, yes, your Honor.

The Court: And did your mother have money or property besides that which was in the estate?

The Witness: No.

The Court: When your father died?

The Witness: No.

The Court: Well, your mother advanced certain moneys to the estate in order to pay obligations, didn't she? Where did she get that money from?

The Witness: You mean—I explained, we had, my mother had to pay on the whole estate. There was nothing hers; she paid on the whole estate and there was money owing. You see the way it was, the deeds of the property—— [199]

The Court: What you are saying doesn't help me at all. All I am trying to find out, your mother apparently advanced some money in order to get the estate closed up. I gather that from the account.

(Testimony of George Ferrari.)

The Witness: Yes, she had borrowed, had to borrow the money from the bank.

The Court: She personally got money from the bank, is that the way she handled it?

The Witness: Well, I had to go—Well, Cosgrove went to the bank and made the loan to pay the taxes off.

The Court: No, that isn't what I am talking about. In the account it shows that the executors paid out a lot more money than they received, and you also say in the account which I read that your mother, the sole legatee of the estate, advanced the money for the payment of these amounts, so that's where you as executors got the money to pay off these various things, is that right, or do you know that?

The Witness: I don't know.

The Court: I don't think it has any particular materiality to this matter, but I was just trying to get the whole picture of the estate. You don't know that?

The Witness: I don't know what you are talking about, that's the only trouble.

The Court: Anything else?

Mr. Gillard: Just one or two further questions.

#### Recross Examination

Q. (By Mr. Gillard): Mr. Ferrari, during the pendency of the estate you had to file income tax returns each year as executors for the income tax and the moneys received as income during the pendency of the administration, did you not?

(Testimony of George Ferrari.)

A. What is that?

The Court: He wants to know, did you file income tax returns during the three years that this estate was pending, accounting for income of the estate.

A. Well, the accountant took care of all that.

The Court: Well, you recall that such returns were filed?

The Witness: Yes.

The Court: All right, go ahead.

Q. (By Mr. Gillard): And you signed at the end of 1946 or the early part of '47, you signed an income tax return for the estate of 1946, did you not?

A. I don't know; I guess so. I guess the accountant took care of that. I wouldn't—

Q. Do you recall signing any returns for income taxes during these years, Mr. Ferrari?

A. Well, taxes were always being paid. I don't know, I guess the accountant took care of that.

Q. You paid the taxes yourself each year as they came due, did you not, to the Internal Revenue service for income taxes?

A. On the estate? [201]

Q. For income taxes for the money earned by the estate during the time you were an executor?

A. I guess so. We always paid the taxes.

Q. You also paid taxes to the State of California for income taxes during the course of the administration of the estate, did you not?

A. Yes, I guess so.



(Testimony of Edward Ferrari.)

you if the signature on Sheet 21 of that return is yours—Edward Ferrari.

A. Yes, that's my signature.

Q. And do you recall when you signed that return?

A. It was sometime in the latter part of 1947.

Mr. Howard: I think that's all the questions I have [204] to ask the witness, your Honor. Oh, before you start, pardon me.

Q. (By Mr. Howard): Mr. Ferrari, did you know Paul Doyle?

A. No, I didn't know Paul Doyle.

Q. Did you ever have any contact with any personnel of the Internal Revenue Bureau during the administration of this estate? A. No.

### Cross Examination

Q. (By Mr. Gillard): At the time you signed the return, Mr. Ferrari, were there a number of sheets involved in the document you signed?

A. There was a number of sheets at the time.

Q. Was the return similar in form to this carbon copy of a return in the estate of Luigi Ferrari? The color of the paper and the size of it?

A. It looked like it.

Q. At the time that you signed the return, did you look over the other sheets?

A. No, I didn't look over no sheets.

Q. Did you look at any page except the signature page? A. No, just signed it.

Q. Do you know of your own knowledge whether

(Testimony of Edward Ferrari.)

there was anything on that return except your signature after you finished signing it? [205]

A. Nothing.

Q. You didn't examine it to see? A. No.

Q. If the figures were in there? A. No.

Q. If the amount of the estate was specified or if the amount of the tax was specified?

A. No.

Q. Now about the same time did you sign that preliminary notice, this Exhibit D in front of you?

A. This preliminary notice, I don't recall signing the preliminary notice.

Q. You don't recall signing that at all?

A. No, I don't.

Q. Is that your signature on there?

A. Yes, that's my signature.

Q. Do you recall reading that document at the time you signed it?

A. No, don't recall signing it.

Q. Now at the time that you signed your name to the estate tax return, was there some discussion about an extension of time?

A. There was a discussion at the time.

Q. What was that discussion.

A. The discussion was that he was to get an extension on [206] the estate, because he didn't have much time left, and that he told us that the tax would be about a hundred thousand dollars, and we said, gee, it was quite a bit. We said we didn't have that kind of money in the estate account to pay, and he says, "Well, then you will

(Testimony of Edward Ferrari.)

have to probably dispose of some of the property in order to pay the tax." And we told him we didn't like to dispose of any of the property if we could help it, and then he says, "What you should do is,"—there were a lot of bills that were owing, and he said, "The thing to do is to clean up these outstanding bills and then when you are a little money ahead, we will see if we can arrange to go to the bank to make a loan. But in the meantime, when you do pay the tax, you are going to have to pay six percent interest.

Q. Now at the time he mentioned that he had to get—he didn't have much time left and he had to get an extension, an extension to do what, did he say?

A. He said that would be the—I understood the extension to pay the tax.

Q. Extension to pay the tax?           A. Yes.

Q. Was there ever any discussion about an extension to file the return?

A. I don't remember any discussion on that.

Q. Did you ever ask him when the return was due? [207]

A. I never asked him whether or not the—when the return was due.

Q. Did you ever ask him if he got an extension to pay the tax?

A. Well, there was no understanding—

Q. Did you ever ask him?

A. No, I never asked him that.

(Testimony of Edward Ferrari.)

Q. Did you ever ask him if he got an extension to file the return?

A. I don't remember asking him that.

The Court: Did he ever tell you that he got an extension?

The Witness: He said he had got an extension.

The Court: What time? At what time?

The Witness: That is what I understood—an extension of the payment of the tax.

The Court: When did he tell you that?

The Witness: That was in '47.

The Court: Was that the same time that he talked about the extension?

The Witness: Yes, about the hundred thousand dollars. That is what I understood.

The Court: Well, you have just told us that in that conversation that you had with him, he said that he would have to get an extension because his time was running out.

The Witness: Well his time was running out, is what I [208] understood. But we didn't have the money to pay it at that time.

The Court: All right. Now did you have another conversation with him later in which he told you he had gotten an extension?

The Witness: Not that I remember.

The Court: Well, when did he tell you that he got the extension, the same conversation he told you he was going to get one?

The Witness: In 1947?

(Testimony of Edward Ferrari.)

The Court: Well, it is not clear to me. See if you can develop it.

Q. (By Mr. Gillard): Mr. Ferrari, you and your brother both appeared as witnesses in the criminal trials involving Mr. Cosgrove?

A. That's right, yes.

Q. At that trial Mr. Cosgrove was represented by Mr. Alioto? A. Yes.

Q. And at that time Mr. Alioto was also your attorney, was he not?

A. Well, he wasn't exactly our attorney. We talked to him about Cosgrove, about we had to pay the penalty.

Q. Wasn't Mr. Alioto your attorney in 1950, '51 and '52?

A. I don't know if he was our attorney. Mr. Howard later on talked to him. [209]

Q. Mr. Howard is in Mr. Alioto's office?

A. I think he was at that time.

Mr. Howard: If the Court please, at that time and at no time have I had any professional association with Mr. Olioto other than we share the overhead in the same suite of offices. I am not his partner, I am not associated with him, at any time within the course of this litigation.

Q. (By Mr. Gillard): Wasn't Mr. Alioto representing you at the same time he was representing Mr. Cosgrove?

A. Well, we went to Alioto at the time, Cosgrove told us to go down and see him.

Q. You went to Mr. Alioto? A. Yes.



(Testimony of Edward Ferrari.)

Q. About your affairs?

A. Well, about—yes, talked to us about, we had to pay a penalty.

Q. About the penalty?           A. Yes.

Q. And you went to him as an attorney to represent you?           A. We went to ask him.

Q. At that time he was involved and engaged in the defense of Mr. Cosgrove in the criminal action?           A. He was.

Q. Now the very first time that this discussion ever came up or any discussion ever came up as to signing this return, the very first time it ever came up, did you say that you had [210] signed that return in October of 1947?

A. Which discussion do you mean?

Q. Any discussion with reference to your return, with Mr. Alioto, or with Mr. Cosgrove.

A. Yes, I told him we had signed it in '47.

Q. You told him that was the first time you ever asked about it?           A. Mr. Alioto?

Q. Yes.

A. Told him we signed the estate tax papers in '47.

Q. You told him that?           A. Yes.

Q. You told him you signed an estate tax return?

A. Similar to that effect, estate tax return.

Q. What do you mean, similar to that effect?

A. Well, I mean that that's what we understood it—I mean, the working, exactly.

(Testimony of Edward Ferrari.)

Q. You signed an estate tax paper, isn't that what you told him?

A. Estate tax paper, yes.

Q. And what you were referring to was that Exhibit B in front of you, weren't you—that preliminary estate tax notice?

A. I don't remember signing that.

Q. You don't remember that, signing that at all?

A. No.

Q. But you clearly remember signing the estate tax return at that time? [211]

A. There was a lot of pages to it, yes.

Q. You had, through your friend Mr. Demartini, some time in 1948,—you saw a return in the estate of Bocci, did you not?

A. No, I didn't talk to Fred Demartini.

Q. You didn't talk to Fred Demartini?

A. No.

Q. Did you ever see an estate tax return of Mr. Bocci?

A. No, I have never seen Mr. Bocci's estate tax return.

Q. In 1948 did you ask Mr. Cosgrove if he had filed an estate tax return?

A. I think it was in '48 some time that, when my brother had got the return from Fred Demartini, where he had seen the, about the fifteen months, we went back and we told Cosgrove and he says, "I know all about the fifteen months," he says. "You didn't have the money to pay, that's why you have to pay an interest when you pay the

(Testimony of Edward Ferrari.)

tax." He says, "As long as you haven't got the money to pay, you have to pay the tax, as long as you have one on file."

Q. Did you ask him about whether the return should be filed?

A. No, he asked us, he told us that he had one on file.

Q. He what?

A. Told us that he had one on file.

Q. He had one filed? A. Yes.

Q. He told you at that time? [212]

A. It was at that time.

Q. Did you so testify in the criminal trial that Mr. Cosgrove told you that?

The Court: Well, you will have to look at it. You can't just ask him.

Mr. Gillard: It is a negative, if the Court please.

The Court: Oh.

A. I don't remember if that's what I testified in the criminal trial. I don't know if I had answered that question, or—at that time.

Mr. Gillard: If the Court please, I don't wish to be off the record here, but my notes don't show anything about such a conversation, but in order to make the representation to the Court or be justified in offering the transcript of their testimony to show the negative that they did not so testify, I would have to further examine the record, and I don't know if I should.

The Court: That he did not testify?

(Testimony of Edward Ferrari.)

Mr. Gillard: That this statement was made, that the return had been filed. I gave you the answer that the brother made, but I don't have the note on this one.

Mr. Howard: I don't know what relevance it would have, unless he was actually asked the question.

The Court: Yes, it wouldn't have any legal effect, Mr. Gillard, unless, as Mr. Howard says, there was some direct [213] question along that line. If he wasn't asked the question, then of course he didn't testify to it. It is always primarily a question of negatives as to whether or not a question was asked, rather than what——

Mr. Gillard: I can't pick it up at this moment, so I will have to let it go.

The Court: All right.

Mr. Gillard: I have no further questions.

The Court: That's all?

Mr. Howard: No further questions.

The Court: That is all, sir. You may step down.

(Witness excused.)

The Court: Now is there any further testimony, Mr. Howard?

Mr. Howard: No further testimony.

The Court: Any further testimony in the Ferrari estate?

Mr. Gillard: Submitted, your Honor.

The Court: Now you want to make some statement about the matter, Mr. Howard?

(Whereupon counsel for the respective parties argued the matter before the Court, after which the following occurred.)

Mr. Gillard: If the Court will permit the re-opening of this case, perhaps counsel will stipulate at the time the returns were filed, if each Mr. Ferrari were called to the stand, he would testify the only persons present in the room [214] were themselves and Mr. Cosgrove.

The Court: You don't mean when it was filed—when it was signed.

Mr. Gillard: I beg pardon. That the only persons present in the office were Mr. Cosgrove and the two Ferraris. Ruth Cosgrove was not there. That was the prior testimony in the criminal case.

Mr. Howard: I will stipulate that.

Mr. Gillard: All right.

The Court: We will submit the case, then, on that basis.

[Endorsed]: Filed April 17, 1956.





Nos. 15,256 and 15,257  
United States Court of Appeals  
For the Ninth Circuit

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MARGURERITE FERRANDO and FRED  
FERRANDO, co-executors of the Last  
Will and Testament of Mario Fer-  
rando, deceased; EDWARD FERRARI  
and GEORGE FERRARI, co-executors of  
the Last Will and Testament of  
Luigi Ferrari, deceased,

*Appellants,*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

BRIEF OF APPELLANTS.

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FILED

JAN 30 1957

PAUL P. O'BRIEN, CL



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Nos. 15,256 and 15,257

# United States Court of Appeals For the Ninth Circuit

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MARGURERITE FERRANDO and FRED  
FERRANDO, co-executors of the Last  
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the Last Will and Testament of  
Luigi Ferrari, deceased,

*Appellants,*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

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## BRIEF OF APPELLANTS.

### STATEMENT OF JURISDICTION.

This is an appeal from final judgments of the United States District Court for the Northern District of California, Southern Division, The Honorable Louis E. Goodman Presiding, entered on the 22nd day of June, 1956. The proceedings below were commenced with the filing on February 16, 1955, of complaints pursuant to Section 3772 of the Internal Revenue Code of 1939 for the recovery of penalties collected

by Appellee upon the alleged authority of Section 3612 (d)(1) of said Code from Appellants as co-executors of the Last Will and Testaments of the above named decedents.

Notice of this appeal was timely filed on July 19, 1956.

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### STATEMENT OF THE CASE.

#### Estate of Ferrari.

Appellants are the sons of Luigi Ferrari who died in San Francisco on August 2, 1946. His last will and testament was admitted to probate on August 30th of that year and on the same day Appellants were appointed co-executors of the will. Forthwith they employed as counsel for the estate Mr. Lloyd J. Cosgrove, a widely known and reputable attorney in their immediate community who, for many years prior to his death, had represented their father in legal matters. Mr. Cosgrove accepted the employment and the Appellants, as the record shows, did everything within their power to furnish him with the assistance and information he required for the task.

The federal estate tax return of the estate became due on November 2, 1947. This time was duly extended in writing in accordance with Treasury Department Regulation 105 until December 2, 1947. Prior to that time, Appellants signed a Federal Estate Tax Return in the office of Mr. Cosgrove. He explained that it was not necessary to pay the tax at that time, but that when it was paid, it would bear interest at the rate of six per cent (6%) per annum. (Tr. 181.)

Although the return was not complete, Mr. Cosgrove nevertheless, left it in the Office of the Deputy Collector of Internal Revenue at San Francisco, Mr. Paul Doyle. Subsequently, in the early part of 1948, Mr. Cosgrove employed the services of the accounting firm of Prior & McClellan to prepare a completed return and finally on April 22, 1949, the return left with Mr. Doyle was corrected by substituting various schedules, the completed return filed and the tax paid in full together with interest to the date of payment.

The Appellants did not know Mr. Paul Doyle and had no knowledge of a discussion or arrangement had by Mr. Cosgrove with him, nor were they aware that the filing of a complete return had been delayed or that possible penalties were involved until shortly before the final return was in fact filed. (Tr. 187-189.)

George and Edward Ferrari were born and raised in the Potrero and Mission Districts in San Francisco. George Ferrari completed High School and his brother, Edward, finished the first year of High School. Although their father and mother had, through great frugality, acquired a substantial amount of property by the time of the father's death, both of these Appellants have earned their livelihood by hard physical labor. Their business consists of buying vegetables in the wholesale market in San Francisco and personally delivering them to the restaurant trade in the city. All of the manual labor involved in the enterprise was carried on by the father, this decedent, and his three sons. A year before the death of Luigi



Ferrari his son, Anthony, died and after the death of Luigi in 1946, the entire burden of the business fell upon the shoulders of these Appellants. As the testimony indicates, they go to work at 4:30 in the morning and their tasks are not completed until late afternoon. The properties which their father and mother acquired, and which their mother acquired through the estate of their father, are managed and operated by the real estate firm of Madison & Burke.

Prior to the death of Luigi Ferrari, neither of these Appellants had ever acted in the capacity of a co-executor nor had they any connection with the probate of estates of decedents. They were totally unfamiliar with the nature of these proceedings in all of their aspects.

#### **Estate of Ferrando.**

The Appellants, Marguerite Ferrando and Fred Ferrando, are the surviving spouse and son, respectfully, of Mario Ferrando who died in San Francisco, California on April 20, 1947. The last will and testament of the deceased was admitted to probate on May 13th of that year and on the same day Appellants were appointed co-executors of the will. Within a few days after the death of Mr. Ferrando, Appellants employed Lloyd Cosgrove as their attorney. As in the Ferrari case, Mr. Cosgrove had represented the deceased in legal matters for many years prior to his death and drew his last will and testament.

Mr. Cosgrove accepted the employment and undertook to do everything required to administer the estate

in probate, including specifically the preparation of estate and inheritance tax returns. (Tr. 36, 67.)

Mr. Cosgrove frequently called upon Appellants for the purpose of signing documents required in the administration of the estate, the marshalling of the assets, and the making of court appearances. According to the testimony of Mr. Cosgrove, Mr. Ferrando responded promptly to all his various requests for information and assistance.

The federal estate tax return involved here became due on July 20, 1948. Mr. Cosgrove did not communicate this fact to Appellants in this case, nor did he take any action to obtain an extension of time within which to file the return. However, on February 8, 1949, Mr. Cosgrove addressed a letter to Mr. Ferrando advising him that the federal estate tax return had been completed, asking that he and his mother come to his office to sign it, and requesting that he "give this matter your usual prompt attention". (Tr. 38, Plaintiffs' Exhibit No. 1.)

Mr. and Mrs. Ferrando responded promptly to this request and shortly after signed the return in the office of Mr. Cosgrove. On or about the 15th day of February, Mr. Cosgrove called Mr. Ferrando and asked that he make out a check in payment of the tax, and that he would arrange to have it picked up. The check stub shows that it was written on February 17, 1949, though the cancelled check shows a typewritten date of July 15, 1948. (Tr. 47, 49—Defendant's Exhibits A and B.) Except for the date, the check was in the handwriting of Mr. Ferrando. Mr. Fer-

rando had no recollection with reference to the omission of the date from the check, and testified that he first became aware of the fact that the date July 15, 1948 was inserted on the check at the time it was offered as an exhibit at the first trial of Mr. Doyle and Mr. Cosgrove.

The estate tax return of the Ferrando Estate was prepared by the Messrs. Prior and McClellan, a firm of Certified Public Accountants whom Mr. Cosgrove employed in the late fall of 1948. (Tr. 97.)

The substance of Mr. Cosgrove's testimony was that prior to the due date of the return (July 25, 1948) he telephoned Mr. Paul Doyle, the Chief Office Deputy Collector of Internal Revenue, and advised him that he would be unable to timely file the return because of the pressure of business and that in response, Mr. Doyle told him to bring the return as soon as time would permit, which Mr. Cosgrove regarded as an indefinite oral extension of time. (Tr. 73.)

Mr. and Mrs. Ferrando never knew Paul Doyle, nor of any arrangements made or conversations had with him by Mr. Cosgrove. They had no knowledge that the return was filed late or that penalties were involved until the Internal Revenue Agents called on them several years later in connection with the investigation of Mr. Cosgrove and Mr. Doyle. (Tr. 40.)

Mrs. Ferrando is an Italian woman who came to this county from Uruguay in 1900 at the age of twelve. She did not attend school beyond the eighth grade. Although she was named co-executor in the will, her son discharged the major share of their

duties in the administration of the estate, though she made all the appearances required and signed all documents when called upon to do so. (Tr. 62, 63.) Fred Ferrando went to Portola Grammar School and to Mission High School in San Francisco, although he did not complete high school. From an early age he worked in his father's concrete contracting business and carried it on after his death.

Neither Mrs. Ferrando nor her son had ever before acted in the capacity of an executor and both were totally unfamiliar with the probate of estates. These facts, together with the fact that they employed an experienced attorney to represent them, were expressly recognized by the Court below in its Opinion and Order for Judgment. (Tr. 17.)

The facts of the cases summarized above are essentially without contradiction in this record, nor do they differ with the undisputed facts before this Court a few years ago in the criminal proceeding involving Mr. Cosgrove and Mr. Doyle, No. 13,626.

The Commissioner of Internal Revenue asserted the penalties in dispute pursuant to Section 3612(d)(1) of the 1939 Internal Revenue Code for failure to timely file the Estate Tax return in question. This action was commenced upon the ground that Appellants were entitled to the benefits of the exception provided in the statute in cases where “. . . *the failure to file . . . was due to reasonable cause and not to wilful neglect . . .*”

Appellants contend that as a matter of law, upon the record presented, they are entitled to the relief prayed for below.



**SPECIFICATIONS OF ERROR RELIED UPON.****Estate of Ferrari.**

1. The United States District Court erred in making the following findings of fact:

(a) The Appellants made no attempt to determine if their attorney was acting with diligence in preparing and filing a federal estate tax return as required by law.

(b) That the Appellants made no attempt to determine whether a federal estate tax return had been filed.

(c) That the Appellants' conduct failed to discharge their duty to prepare and file a federal estate tax return.

(d) That the Appellants were guilty of wilful neglect in failing to determine whether their attorney was acting with diligence in the preparation and filing of a federal estate tax return.

(e) That the failure to file a federal estate tax return within the period prescribed by law was not due to reasonable cause as to the Appellants.

2. The United States District Court erred in respect of the following conclusions of law:

(a) That the Appellants' conduct failed to discharge their duty to prepare and file a federal estate tax return.

(b) That there was no reasonable cause on the part of appellants for failure to file a federal



estate tax return within the period prescribed by law.

(c) That the Appellants' failure to file a federal estate tax return within the period prescribed by law was due to Appellants' wilful neglect.

(d) That the penalties assessed by the Appellee against the Appellants were validly assessed pursuant to the provisions of Section 3612(d)(1) of the Internal Revenue Code of 1939.

(e) That the Appellee was properly entitled to judgment in this cause.

3. The United States District Court, in its Opinion and Order for Judgment, erred in the following respects:

(a) The Court's statement to the effect that the showing made by Appellants that the delinquent filing in question was not due to any neglect on their part, is wholly lacking in clarity and persuasiveness, is not sustained by the evidence in the case.

(b) The Court's statement, that the testimony of Appellants to the effect that before the due date of the return they in fact and in good faith signed a completed return, is so equivocal and lacking in forthrightness that it is unacceptable, and is not only inconsistent with the Court's own conclusions of law and findings of fact, but is wholly unjustified by the record in the case.

(c) The Court erred in its statement that the Appellants failed to sustain their burden of show-

ing that the delinquent filing is due to reasonable cause and not to wilful neglect, because said statement is not sustained by the evidence in the case.

**Estate of Ferrando.**

1. The United States District Court erred in making the following findings of fact:

(a) The plaintiffs made no attempt to become familiar with their duties and obligations as executors of the Estate of Mario Ferrando.

(b) That plaintiffs, as co-executors of the last will and testament of Mario Ferrando, made no attempt to determine whether the attorney employed by them was acting with due diligence in preparing the federal estate tax return.

(c) That plaintiffs' conduct failed to discharge the duty to prepare and file a federal estate tax return.

(d) That there was no reasonable cause for the failure of plaintiffs to file a federal estate tax return within the time prescribed by law.

(e) That the failure of plaintiffs to make and file a return within the time prescribed by law was due to willful neglect.

2. The United States District Court erred in respect of the following conclusions of law:

(a) That the plaintiffs' conduct failed to discharge the duty to prepare and file a federal estate tax return.

(b) That the failure to file a federal estate tax return within the time prescribed by law for the Estate of Mario Ferrando is due to plaintiffs' willful neglect.

(c) That there is no reasonable cause for the failure of plaintiffs to file a federal estate tax return within the period prescribed by law.

(e) That the defendant was properly entitled to judgment in this cause.

3. The United States District Court erred in its Opinion and Order for Judgment in its conclusion that on the evidence in the case, with particular reference to the Court's acknowledgment of the facts that the plaintiffs were wholly unfamiliar with the administration of estates and employed an experienced attorney to represent them, that as a matter of law they nevertheless failed to discharge their duty of reasonable care in the circumstances.

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## **ARGUMENT.**

### **1. SUMMARY OF ARGUMENT.**

(a) The statute under which the penalties in question were assessed and collected is Section 3612 (d) (1) of the Internal Revenue Code of 1939, which so far as applicable reads as follows:

“(d) Additions to Tax:

(1) Failure to File Return—In case of any failure to make and file a return or list, within the time prescribed by law, or prescribed by the

Commissioner or Collector in pursuance of law, the Commissioner shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to reasonable cause and not to wilful neglect, no such addition shall be made to the tax . . .”

(b) The Regulations of the Treasury Department and the decisions of the Courts have established the basic proposition that:

“the delay is due to reasonable cause if the taxpayer exercised ordinary care and prudence.”

(c) The Appellants in these cases contend that when, upon the death of their kin, they:

(1) Recognized their utter incapacity by reason of experience, training, education and background to discharge the manifold duties of the administration in probate of estates, including the task of preparing and filing complex federal tax returns, and

(2) Entrusted the performance of those duties to an attorney of outstanding reputation in their community whom they had known and relied upon for many years and was by reason of professional association familiar with the affairs of the deceased, and

(3) Did everything within their limited power to furnish their attorney with the tools and information required for the task, and responded to his every request for cooperation,

that they did everything that the law could expect of them as reasonable, prudent and conscientious individuals in the fulfillment of their obligations to the United States with respect to the filing of the federal estate tax return. Accordingly, they contend, the imposition of the penalties in question was illegal and erroneous, and that they ought to be refunded.

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## 2. ANALYSIS OF THE EVIDENCE.

### (a) Wilful Neglect.

The Appellants in both these cases do not hesitate to say most emphatically that the finding of the Court below that the failure to file the return in question within the time prescribed by law was due to their wilful neglect is wholly unsupported by the evidence. This is not a question of insufficiency of the evidence—there is no evidence at all to support the finding.

### (b) Reasonable Care and Prudence.

#### Estate of Ferrari.

##### 1. Selection of Counsel.

At the time of their father's death, George and Edward Ferrari knew Lloyd Cosgrove not only as their father's attorney of many years standing, but as a well-known and reputable lawyer in their immediate community. Mr. Cosgrove had drawn the will of Mr. Ferrari and, quite naturally and promptly, after the death of their father, George and Edward turned to Mr. Cosgrove for his professional services required to settle the estate. Mr. Cosgrove accepted their em-



ployment and specifically undertook to do everything that was necessary to complete the administration of the estate, including the preparation and filing of such tax returns as may be required. (Tr. 113.) It is true that the Appellants did not inquire of Mr. Cosgrove as to whether he was an expert in matters relating to Federal Estate taxation, but the reason is plainly obvious. At that point they had no knowledge, nor had they ever had any occasion to become familiar with the laws or facts relating to Federal Estate taxes. They could not in the nature of things conceive of Federal Estate taxes as something separate and apart from the general administration of estates in probate, and thus exercise an independent judgment that some tax expert ought to be employed. That very decision itself had to be left to Mr. Cosgrove and he assumed the duty of making it.

## **2. Cooperation With and Assistance to Counsel.**

As the probate file before the Court, and the testimony of the Appellants and Mr. Cosgrove, plainly indicate, Appellants responded to every request of Mr. Cosgrove for information and documents required by him in connection with the probate of the estate, made the necessary Court appearances, signed petitions and pleadings necessary, and consulted with him in his office on many occasions with respect to the various problems of administration of the estate.

## **3. Conduct of Appellants in Relation to Return.**

With respect specifically to the federal estate tax return in question here, the testimony is clear and

uncontradicted that in the late fall of 1947 George and Edward Ferrari signed a federal estate tax return (which they referred to as federal estate tax papers) in the office of Mr. Cosgrove. This evidence has not been impeached or impugned in any way, and it is consistent with the testimony offered by Mr. George Ferrari in the criminal action involving Mr. Cosgrove in 1952 which counsel for the government quoted in this proceeding. (Tr. 181.) In the criminal proceeding, Mr. Edward Ferrari, as the government's own witness, testified that he signed the federal estate tax return and the preliminary notice "about the same time". The preliminary notice, as was stipulated in this proceeding, was filed in the Office of the Collector of Internal Revenue on December 2, 1947. To this must be added the Court's own conclusion in this case. (Tr. 27, No. 2.)

"That *the return filed on December 2, 1947 . . .* did not comply with the provisions of Section 821 . . ."

#### 4. Mr. Cosgrove's Conduct in Relation to Return.

The substance of the testimony of Mr. Cosgrove with respect to the return was that he thereafter brought it to the office of Mr. Paul Doyle in an incomplete condition because of estimated valuations and lack of detail relating to liabilities, and at the time that the tax was paid in 1949 he went to Mr. Doyle's office, attempted to make certain corrections on this return, and then at the suggestion of Mr. Doyle took the return back to his office and retyped it. (Tr. 157.)

However improbable the latter testimony may be, there is no room to dispute the evidence in this case that a return was in fact signed by the Ferraris in the office of Mr. Cosgrove during the latter part of 1947. It is to be noted that the first sheet and the signature sheet of the federal estate tax return in evidence in this proceeding as Exhibit A bear a different serial number than the other sheets in the return, which indicates the signature page was signed at a time other than the time when the pages containing the detail with respect to assets and liabilities were inserted.

It is the unchallenged testimony of Appellants that they had no knowledge whatever of what transpired with respect to the return after the time they had signed it, except the representations that were made to them by Mr. Cosgrove on a number of occasions, as indicated in the testimony, that a return was in fact on file. These representations were made to the Ferraris by Mr. Cosgrove on three occasions:

First of all, when the Appellants asked Mr. Cosgrove if it was too late to change the valuations for Federal Estate tax purposes in the early part of 1948, at which time Mr. Cosgrove advised them that they could always make the change; (Tr. 183)

Second, when later in 1948 through Mr. DeMartini they learned of the requirements appearing on the face of Form 706 that "the tax is due 15 months after the date of the decedent's death", they went promptly to Mr. Cosgrove's office to inquire as to the status of the matter and were assured by him then that as long

as a return was on file, the (together with the statutory interest) tax could be paid as soon as the money was raised (Tr. 187); and

Finally, when this matter was raised again in 1949 after Mr. Baier, the attorney, had indicated to them the possibility of penalties being involved. (Tr. 189.)

**5. Appellants Unaware a Complete Return Had Not Been Filed.**

The relevance of the testimony of Mr. Cosgrove with reference to his relationship with the Office of the Collector of Internal Revenue in this proceeding was that there was no conduct on his part of which the Appellants could have been aware that would have put them on notice that the filing of the return had not been properly attended to, and that therefore some duty devolved upon them independently to see that some action was taken.

It is to be noted that, consistent with their understanding of the matter, the Appellants in this case, after arrangements had been made to borrow money to pay the tax, furnished Mr. Cosgrove not only with a check in payment of the tax reflected on the return, but a check in payment of the interest in full to the date of payment, both checks being dated as of the date of payment.

**6. What More Was to Be Expected of Appellants?**

It seems incomprehensible that any standard of reasonable care would then impose upon Appellants a personal duty to see that the return was filed in the office of the Collector of Internal Revenue any more than reasonable care would require that they see that



every other document involved in a probate proceeding was in fact filed with the proper official.

It seems grossly unreasonable to expect that the Appellants here should have been apprehensive that Mr. Cosgrove would not perform his duty in the filing of the return, when it appears that in fact he was performing his duties with respect to every other phase of the probate proceeding. It seems irrational to insist that executors of the experience and background of these Appellants should be asked to comprehend a different standard of obligation or duty or responsibility with respect to one phase of the probate of an estate than with regard to all other phases of the probate of an estate.

One might ask the question, "what should the Appellants have done here that they didn't do?" Should they personally have taken the return after it was signed to the Office of the Collector of Internal Revenue? Should they have gone to 100 McAllister Street, sought out the Estate Tax Division, independently inquired as to the law and regulations as respects the filing and payment of the tax, and to have checked the records from time to time to see that the return was filed or that extensions were duly obtained? Was there information required which they failed to furnish Mr. Cosgrove? Was there any action taken by them which prevented Mr. Cosgrove from doing his duty? Did anything occur within their knowledge that should have put them on notice that things were not right, from which a duty to take independent action would arise?



All these questions must be answered in the negative, and Appellants assert again that in good faith they did everything that could be expected of reasonable and prudent men to discharge their duty to the government in respect of this action.

### **Estate of Ferrando.**

#### **1. Background and Experience of Appellants.**

Marguerite Ferrando, the widow of the deceased and a co-executor of his estate, was an elderly woman of little education. The testimony indicates that although she signed the various documents involved in the probate proceeding, and accompanied her son and co-executor, Fred Ferrando, to various meetings with their attorney, Mr. Cosgrove, she relied upon her son almost completely and discharged her duties under his direction.

Fred Ferrando grew up in the Mission District and did not himself complete high school. Upon finishing school he went to work in his father's concrete contracting business, and upon his father's death carried on the business.

In the conduct of this business he gained some familiarity with periodic tax returns of various types that are generally required to be filed in connection with the operation of a business and with respect to the income of individuals. He testified however that his income tax returns were prepared by accountants and that unemployment and withholding tax returns were prepared by a girl in his office and that his main responsibility was the payment of the tax itself. In

response to the question of government counsel that he was familiar with the fact that withholding taxes and unemployment taxes for the State were reported to the Franchise Tax Commission, he answered in the affirmative. This of course is not true, and inasmuch as there is no State withholding tax, and unemployment taxes are paid to the Department of Employment. (Tr. 41, 43.)

## **2. Selection of Counsel.**

Mr. Ferrando testified that he had known Mr. Cosgrove for 18 years, and from time to time Mr. Cosgrove had represented him in various legal matters. He stated that Mr. Cosgrove had drawn his father's will and that, in the normal course of events, he turned to Mr. Cosgrove upon his father's death. He stated that he employed Mr. Cosgrove for the purpose of taking care of all matters required to be attended to in the course of the probate and administration of an estate.

## **3. Cooperation With and Assistance to Counsel.**

Mrs. Ferrando testified that she knew of the excellent reputation of Lloyd Cosgrove in the community as an attorney, and that with her son she necessarily placed the burdens and responsibilities of administration of the estate in his hands. Mr. and Mrs. Ferrando testified, as did Mr. Cosgrove, that they complied with all of the requests of the latter for documents, and in due course and as they were asked, they signed the various petitions and affidavits required and made the necessary Court appearances.

#### 4. Conduct in Relation to the Return.

With respect to the Federal Estate Tax, Mr. Ferrando testified that he received from Mr. Cosgrove a letter dated February 8, 1949 in which it was stated that the Federal Estate Tax return had been prepared, and asking that he and his mother call at the office for the purpose of signing it. The letter concluded, "Please give this matter your usual prompt attention". Mr. Ferrando testified that shortly after that time Mr. Cosgrove called and asked that Mr. Ferrando send him a check in the amount of \$14,525.69 in payment of the tax disclosed on the return. He testified that the date appearing on the check, July 15, 1948, was not put on by him, but he does not recall the circumstances under which it was omitted at the time he made the check up.

Mr. Ferrando had no prior experience as an executor, and had never participated before this time in the probate of an estate. He had no independent knowledge as a layman as to the nature of these proceedings, including such things as Inventories and Appraisements, Inheritance Tax Affidavits, Estate Tax Returns, etc. There was no conceivable way in which he in his own mind could separate from the duties devolved upon Mr. Cosgrove one phase of the probate of the estate or another. He could not isolate the matter of the Federal Estate Tax return or the Inventory and Appraisal or the preparation of an Inheritance Tax Affidavit out of the whole fabric of the probate and reserve to himself special responsibility or devolve it upon someone else, because he had no comprehension of those things at all.

It is inconceivable that Mr. Ferrando, or any person with his background and experience, could have entertained a notion that the laws relating to Federal Estate taxes were something separate and apart from the general problems involved in the probate of an estate, which then placed special responsibility on him or required him to turn to someone other than his attorney.

**5. There Was No Reason for Appellants to Distrust Mr. Cosgrove.**

Examination of the testimony of Mr. Ferrando and Mr. Cosgrove, and a review of the file of the Superior Court, which was before this Court in this proceeding, negatives any suggestion or inference that Mr. Ferrando had any reason to doubt the competence of Mr. Cosgrove to handle all of the various phases of the probate administration, or that he was in any way neglecting his duties and responsibilities in the matter. There is also a striking absence of any fact or circumstance which might have served to bring to the attention of Mr. Ferrando any such feeling. The letter of February 8, 1949 is obviously routine in nature and, if any doubts were then in Mr. Ferrando's mind, could serve only to reassure him that matters were being attended to in the normal course of events.

It is of interest to note that at the time of the letter and at the time of the filing of the return in the Ferrando Estate, the time for the payment of the State Inheritance Tax (two years after the date of death), had not yet expired. Obviously it is not to be expected that a layman would, in his own mind, dis-

tinguish between the two unless it were specifically called to his attention.

Assuming, arguendo, that the apparent request of Mr. Cosgrove, or someone in his office, to Mr. Ferrando, to leave the check in payment of the tax undated should have aroused some suspicion in his mind at that time as to the status of the return, this event occurred a long time after the due date of the return had passed, and a substantial period of delinquency had expired.

The testimony of Mr. Ferrando and his mother on direct examination remained substantially unchallenged. It was not contradicted or impeached in any way whatsoever.

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### **THE LAW OF THE CASE.**

We have quoted the provision of the Internal Revenue Code involved in this proceeding on pages 11-12.

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#### **1. MEANING OF TERMS.**

There are no Treasury Department Regulations construing this Section of the Code, but Section 39.291-1 of Income Tax Regulations 118 states, with reference to similar language in the income tax law, that:

“the delay is due to reasonable cause . . . if the taxpayer exercised ordinary care and prudence . . .”



With reference to the parallel provision of the income tax law (Section 291, Internal Revenue Code of 1939), the Supreme Court of the United States in *Spies v. United States*, 317 U.S. 492, 63 Supreme Court 364, has declared that:

“It is not the purpose of the law to penalize frank difference of opinion or *innocent errors made despite the exercise of reasonable care.*”  
(Italics ours).

In an exhaustive review of the authorities on the subject, the Third Circuit Court of Appeals in a leading decision, *Hatfried, Inc. v. Commissioner of Internal Revenue*, 162 Fed. 2nd 628, concluded:

“The Courts, as above stated, have ruled that ‘reasonable cause means nothing more than the exercise of ordinary care and prudence’ and ‘willful’ as ‘intentional or knowing or voluntary’.”

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## 2. RELIANCE ON COUNSEL.

In the *Hatfried* decision, *supra*, which involved a failure of an accountant for the taxpayer, upon whom he had relied, to file a personal holding company return, the Court said:

“To hold that a taxpayer who selects as his agent a certified public accountant (to whom as a class the Treasury Department and The Tax Court itself accord recognition as ‘experts’ and as ‘counsel’) *has failed to exercise ‘ordinary care and prudence’ and becomes liable for the error of his advisor as ‘agent’ is an inconceivable proposition*” (Italics ours).

This remark and the one quoted above from the Court's opinion were made in answer to the broad contention of the government "that ignorance of the law is no excuse, whether that ignorance is on the part of the taxpayer or his advisor."

The leading case on the general subject involved here is the decision of the Second Circuit Court of Appeals in *Haywood Lumber & Mining Company v. Commissioner of Internal Revenue*, (1950) 178 Fed. 2nd 769. There, a corporation executive consulted a qualified certified public accountant and placed before him all necessary information about the affairs of the corporation which the accountant would require for the purpose of filing its return. The accountant admitted that he knew that the taxpayer was in fact a personal holding company, but through inadvertence failed to inform the officer of the corporation of this fact and to prepare the return in question. The executive was aware of the personal holding company statute, but had not studied its application and it did not occur to him that the corporation was in fact a personal holding company. The Tax Court sustained the imposition of the penalty but the Circuit Court of Appeals reversed. The Court pointed out that "reasonable cause" as used in the statute is defined in the Regulations (Section 39.291-1) to mean "that the taxpayer exercised ordinary business care and prudence". The Court of Appeals said:

"When a corporate taxpayer selects a competent tax expert, supplies him with all the necessary information, and requests him to prepare proper tax returns, we think the taxpayer has

done all that ordinary business care and prudence can reasonably demand . . .”

“Respondent contends that where all the responsibility for the preparation of tax returns is delegated to an agent, the taxpayer should be held to accept its agent’s efforts, cum onere, and be chargeable with his negligence . . . Further reflection convinces us that that proposition is not sound. The standard of care imposed by Section 291 is personal to the taxpayer. To impute to the taxpayer mistakes of his consultant would be to penalize him for consulting an expert; for he must take the benefit of his accountant’s advice, cum onere, then *he must be held to a standard of care which is not his own and one which in most cases would be far higher than that exacted of a layman.*” (Italics ours).

We find no conceivable basis upon which these cases can be distinguished from the *Haywood* decision, though we do feel that the equities of these cases are stronger. The *Haywood* decision, for example, involved a corporation executive who had some familiarity with the statute involved and who, it is to be presumed, had a general knowledge of taxing statutes as a whole, so far as filing returns are concerned. Upon the facts, however, it is inconceivable that the same Court would view Messrs. Ferrando and Ferrari, for example, in a less favorable light.

The Treasury Department has now recognized the preponderance of authority which has followed the *Haywood* decision, and has accorded limited recognition to the principle enunciated. The Service will now excuse the late filing penalty in the cases of failure

to file personal holding company returns where there was reliance on the advice of tax counsel to the effect that no return was due. See *Revenue Ruling 172, 1953-2 CB 226*.

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### 3. FAILURE TO FILE AS DISTINGUISHED FROM ERRONEOUS ADVICE.

It is to be noted that the *Haywood* case, *supra*, involved mistake and inadvertence on the part of the taxpayer's counsel, who knew a return was in fact due. Thus, its application cannot be limited, as the Government would have it, to the erroneous exercise of judgment on the part of the adviser, but on the contrary applies as well to the consequences of the adviser's neglect or mistake.

This precise proposition has been affirmed by the Sixth Circuit Court of Appeals in *Fisk v. Commissioner of Internal Revenue*, 203 Fed. 2nd 358, a case involving the late filing of a Federal Estate Tax Return. In reversing the Tax Court, this Court said:

"We think the addition of the penalty constituted error as a matter of law. The question of the existence of reasonable cause is in the first instance one for The Tax Court . . . which must decide whether the elements which constitute reasonable cause are present in the case. What elements must be presented to constitute reasonable cause is a question of law . . .

"In *Hatfried, Inc. v. Commissioner*, *supra*, where it appeared that the only possible conclusion on the record was that the failure to file a personal holding company return was made on



an accountant's advice, the Third Circuit held that the finding that there was no reasonable cause was not sustained by substantial evidence. Whether we adopt the theory of this case or of the cases which *hold that in such matters reliance upon an attorney constitutes reasonable care as a matter of law*, the result is the same and the decision herein is erroneous . . .

“We adhere to the rules stated in *Haywood Lumber & Mining Co.*, supra, that as a matter of law reasonable cause was shown in this case. *This rule, we hold, applies to the filing of tax returns as well as to reliance upon technical advice in complicated legal matters.* We think this conclusion is in accord with the principle declared by the Supreme Court that the penalties under the revenue laws were designed to be imposed upon conduct ‘which is intentional, or knowing, or voluntary, as distinguished from accidental’ . . .

“ ‘It is not the purpose of the law to penalize . . . innocent errors made despite the exercise of reasonable care.’ *Spies v. United States*, 317 U. S. 492 . . . ”

The Tax Court recently followed this decision in an income tax case, *Lee Field, et al. v. Commissioner*, January 21, 1955, 14 T.C.M. (CCH Decision No. 2080 (M)). In that case the petitioners signed in blank a federal income tax return and left it with a public accountant with whom they had had previous business to prepare and file. The accountant, Mr. Eigen, completed the return in time for filing on the due date but, through inadvertence, placed it in the wrong file and it was not discovered until several



months later. Upon the authority of the *Estate of Kirchner*, 46 B.T.A. 578, and *Fisk v. Commissioner*; supra, the Tax Court concluded that the failure to file the return in time was due to reasonable cause and not to willful neglect.

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#### 4. ESTATE TAX CASES.

The question here has been raised in a number of estate tax cases. Preliminarily, it should be pointed out that the filing of a federal estate tax return is a vastly different matter than filing a federal income tax return. To begin with, only a small fraction of estates subject to probate are required to file federal estate tax returns. In the second place, and of more significance, the responsible party in the case of estates very often becomes such solely by virtue of chance or by virtue of the relationship which he or she happens to occupy to the decedent. The vast majority of people are never in their lifetimes called upon to perform the duties of an executor, and to those upon whom the responsibility falls, it rarely happens more than once in a lifetime. As contrasted with this, the obligation to file federal income tax returns or ordinary sales tax returns or withholding returns, for example, might well be described as common knowledge, and it is an obligation which people in the ordinary course of affairs discharge many times in their lifetime.

The earliest decision on the precise question involved here is *Adelaide McColgan v. Commissioner*, 10

B.T.A. 959. This is a decision in which the Commissioner of Internal Revenue acquiesced. (VII-2 CB 26). In that case the Board of Tax Appeals said, with respect to the question of liability for the delinquency penalty:

“Upon consideration of the evidence presented as to the third issue, we are of the opinion that the delinquency penalty for failure on the part of the petitioner to file an estate tax return within the time prescribed by law should not be asserted. Petitioner is a woman evidently unfamiliar with either the laws of California or the United States. She relied upon her attorney who advised her that under the circumstances the filing of an estate tax return for the decedent’s estate was not required. She followed that advice . . . We think that under the circumstances the petitioner’s failure to file an estate tax return on time was due to reasonable cause and not due to willful neglect and therefore the imposition of the penalty for such failure is not authorized.”

In this estate, of course, the Appellants were completely unfamiliar with the laws of the State of California and of the United States relating to estates and inheritance taxation. They did, however, on many occasions discuss the progress of the estates in question with Mr. Cosgrove, the attorney in question, and repeatedly urged him to complete administration in every detail in order that the estates might be distributed as soon as possible. They did, in fact, do everything that was possible and could reasonably be expected of persons in their position to secure compliance not only with the laws of the United States but

with the laws of the State of California with respect to the administration of estates.

In the *Estate of Frederick C. Kirchner v. Commissioner*, 46 B.T.A. 758, which was decided 14 years later, there was involved an executrix, the widow of the deceased who, during the period of administration, "was not physically or mentally capable of looking after her business affairs. She was 65 years of age and had little or no knowledge of business affairs." Administration of the estate and the filing of tax returns was entrusted to a series of attorneys and an accountant who, for various reasons, failed to give proper attention to the matter of filing the tax returns. The Court held under the circumstances that the failure to file the return was due to reasonable cause, and that the Commissioner erred in imposing the penalty.

The Tax Court held similarly in 1950, in the case of the *Estate of Phillip S. Reichers*, 9 T.C.M. 403. The Court said:

"The widow and her father were the executors of the decedent's estate. Neither had any experience as executors. The widow left all matters having to do with the estate to her father. He went to Levitt, a reputable, experienced attorney, and asked him to take care of everything in connection with the estate. Levitt assured him that he would do so."

It is true that The Tax Court has decided cases against the taxpayer on this question, but we are confident that this Court will readily observe the distinc-

tion between those decisions and the cases on which we rely. For example, in the *Estate of Curie*, 4 T.C. 1175, The Tax Court sustained the imposition of the penalty in a case in which the executor admittedly had full information necessary to file a return well within the time prescribed by law, and in addition had been warned by the Commissioner seven months and three months prior to the due date that the return must be filed in order to avoid the imposition of penalties. Obviously, on these facts there is no room for the contention that the failure to file was due to reasonable cause and, as a matter of fact, the Court suggested that willful neglect might be involved.

In *Estate of Abraham Werbalowski*, 9 T.C. 689, the Court, in sustaining the imposition of the penalty, distinguished the *McColgan* case upon the ground that the record did not show any clear understanding with the estate's attorney as to his responsibility so far as it covered federal estate tax matters, including the preparation and filing of the return. The evidence indicated that this responsibility devolved upon an accountant and it was also clear from the record that the executors personally undertook to discharge many of the chores required in the administration of the estate itself.

In *Estate of Arthur D. Cronin*, 7 T.C. 1403, the Court rejected the plea that where a failure to file a Federal Estate Tax return occurred because the attorney for the executor was not aware that there was any specific limit on the filing of the return was not attributable to reasonable cause. The Court said



that mere ignorance of the plain and unambiguous provisions of the statute and regulations prescribing the time for filing returns cannot be considered reasonable cause.

The decision in the *Cronin* case gives only cursory attention to the matter of the late filing of the return. It is not clear from the record what the exact circumstances of the case were. It is to be noted that three Tax Court judges dissented in the decision but it is not clear as to whether they dissented with respect to this issue or another issue which was in the case.

As pointed out above, the leading decision at the present time so far as estate tax returns are concerned is now the decision of the Sixth Circuit Court of Appeals in *Fiske v. Commissioner of Internal Revenue*. We feel that that decision is conclusive upon the issue presented in this case.

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#### 5. DELAY IN PAYMENT OF TAX DISTINGUISHED.

These cases, of course, involve the payment of penalties expressly imposed in cases where there has been a failure to file a return on time without reasonable cause. The Internal Revenue Code of 1939 does not impose any penalty for the failure to pay estate or gift taxes within the time prescribed by law, although Section 145 of the Code does impose penalties for the failure to pay income taxes within the time prescribed by the law. The only statutory burden that must be met where estate taxes are paid late is the interest (6%) requirement.



It is also interesting to note that the Treasury Department Regulations 105 then in effect limits the Commissioner's authority to grant extensions of time for the filing of returns (Section 81.69) to three months, whereas in any case where the payment of the tax on the due date would impose undue hardship upon the estate, the Commissioner had authority to extend the time for payment for a "period or periods not to exceed in all ten years from the due date." (Section 81.79.)

These matters are pointed out especially with reference to the testimony in the Ferrari case that the Appellants here were made aware at the outset that delay in the payment of the tax would result in a 6% interest obligation, and that this obligation was met by them at the time of payment, and as of the date of payment. Thus, even though it be said that as a legal proposition, Appellants are foreclosed from pleading ignorance of the law, judgment for the government does not necessarily follow. For on the record, they acted in a manner consistent with the law; their error, if any, was reliance upon their attorney's representation of fact—that a return was in fact filed before the due date as extended.

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### CONCLUSION.

To state again the position of the Appellants in these actions, we feel strongly that the application of the principles of the decisions discussed above, which we are certain represent the weight of authority on

the question presented, will lead unerringly to the conclusion that when these Appellants consulted with Mr. Cosgrove, an attorney of long-established reputation, and whose confidence in him was based not only on that reputation but on the personal experience of their respective families over many years of time, and cooperated with him fully that they had "done all that ordinary business care and prudence can reasonably demand".

Dated, San Francisco, California,  
January 21, 1957.

Respectfully submitted,  
HENRY W. HOWARD,  
*Attorney for Appellants.*

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Nos. 15,256 and 15,257

IN THE

United States Court of Appeals

For the Ninth Circuit

MARGUERITE FERRANDO and FRED FERRANDO,  
co-executors of the Last Will and Testa-  
ment of Mario Ferrando, deceased,

*Appellants,*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

No. 15,256

EDWARD FERRARI and GEORGE FERRARI, co-  
executors of the Last Will and Testa-  
ment of Luigi Ferrari, deceased,

*Appellants,*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

No. 15,257

On Appeal from the Judgments of the United States District  
Court for the Northern District of California.

BRIEF FOR THE APPELLEE.

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FILED

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PAUL P. O'BRIEN, CLERK





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Nos. 15,256 and 15,257

IN THE  
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vs.

UNITED STATES OF AMERICA,

*Appellee.*

No. 15,257

**On Appeal from the Judgments of the United States District  
Court for the Northern District of California.**

**BRIEF FOR THE APPELLEE.**

---

**OPINIONS BELOW.**

The opinion (R. 17), findings of fact and conclu-  
sions of law (R. 21-25) of the District Court in No.  
15,256 are not reported. The opinion (R. 20-22), find-

ings of fact and conclusions of law (R. 24-28) of the District Court in No. 15,257 are not reported.

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### **JURISDICTION.**

These appeals involve federal estate taxes.

In No. 15,256, the jurisdictional facts are as follows: The taxes in dispute were paid on January 4, 1952. On December 10, 1952, the executors filed with the District Director of Internal Revenue at San Francisco, California, a claim for refund of the additions to tax collected. (R. 23.) This claim was rejected on October 7, 1953. (R. 24.) Within the time provided in Section 6532 of the Internal Revenue Code of 1954, and on April 20, 1955, the executors brought an action in the District Court for recovery of the taxes paid. (R. 4-7.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. Judgment was entered on June 22, 1956. (R. 25-26.) Within sixty days and on July 19, 1956, a notice of appeal was filed. (R. 26.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

In No. 15,257, the jurisdictional facts are as follows: The taxes in dispute were paid as follows: \$3,982.13 on March 1, 1951, and \$25,257.83 on December 14, 1951. (R. 6, 26.) Claim for refund was filed on February 16, 1953 (R. 27), and was rejected on October 7, 1953. (R. 27.) Within the time provided in Section 6532 of the Internal Revenue Code of 1954, and on April 20, 1955, the executors brought an action in the District Court for recovery of the taxes paid.

(R. 4-7.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. Judgment was entered on June 22, 1956. (R. 29-30.) Within sixty days and on July 19, 1956, a notice of appeal was filed. (R. 30.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

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### **QUESTION PRESENTED.**

Whether the District Court was correct in holding that the failure to file estate tax returns within the period prescribed by law was due to wilful neglect rather than reasonable cause.

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### **STATUTE INVOLVED.**

The pertinent statutory provisions are set forth in the Appendix, *infra*.

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### **STATEMENT.**

The District Court made findings of fact and conclusions of law in each case which may be summarized as follows:

*No. 15,256—the Ferrando case.* Mario Ferrando died on April 20, 1947. Marguerite Ferrando and Fred Ferrando were appointed co-executors of the last will and testament of Mario Ferrando on February 13, 1948. They did not file a federal estate tax return with the office of the United States Collector of Internal Revenue for the First District of California,



San Francisco, California, on or before July 20, 1948. They did not receive an extension of time to allow them to file a federal estate tax return later than July 20, 1948. (R. 21-22.)

The executors employed an attorney to prepare and file a federal estate tax return. This attorney failed to prepare and file the return prior to February 7, 1949. The executors knew that a federal estate tax return was required and that an estate tax would have to be paid. They made no attempt to determine whether the attorney employed by them was acting with due diligence in preparing the estate tax return or to become familiar with their duties and obligations as executors under the will of Mario Ferrando. (R. 22.)

The executors did not attempt to determine whether their attorney filed a federal estate tax return within the period prescribed by law. Their conduct failed to discharge the duty, placed upon them by Section 821 of the Internal Revenue Code of 1939, to prepare and file a federal estate tax return. There was no reasonable cause for their failure to file a federal estate tax return within the time prescribed by law and their failure to do so was due to wilful neglect. (R. 23.)

*No. 15,257—the Ferrari case.* Luigi Ferrari died on August 2, 1946, and thereafter on August 30, 1946, Edward Ferrari and George Ferrari were duly appointed as co-executors of his last will and testament. The executors obtained an extension of time to and including December 2, 1947, within which to file the federal estate tax return for the estate of Luigi Fer-

rari required by the Internal Revenue Code of 1939. (R. 25.)

On April 22, 1949, a federal estate tax return was filed with the office of the Collector of Internal Revenue for the First District of California, San Francisco, California, for the estate of Luigi Ferrari. The executors did not file a return as prescribed by law prior to that date. (R. 25.)

The executors employed an attorney to prepare and file the estate tax return. The failure to file the return within the allowed period was due to the attorney's wilful neglect. The executors knew that an estate tax return was required and that an estate tax would have to be paid. They made no attempt to determine if their attorney was acting with diligence in preparing and filing the return or to determine whether a return had been filed within the period prescribed by law. Their conduct failed to discharge the duty, placed upon them by Section 821 of the Internal Revenue Code of 1939, to prepare and file a federal estate tax return. They were guilty of wilful neglect in failing to determine whether their attorney was acting with diligence in the preparation and filing of the return. There was no reasonable cause for their failure to file a federal estate tax return within the time prescribed. (R. 25-26.)

In each case additions to tax for failure to file the required returns within the prescribed period were assessed pursuant to Section 3612(d)(1) of the Internal Revenue Code of 1939. (R. 23, No. 15,256; R. 26, No. 15,257.) The District Court concluded in each

case that the additions to tax were properly assessed pursuant to the provisions of Section 3612(d)(1). (R. 24-25, No. 15,256; R. 28, No. 15,257.)

---

### **SUMMARY OF ARGUMENT.**

The District Court found in each case that the failure of the executors to file the required estate tax return within the period prescribed by law was due to wilful neglect rather than reasonable cause. The burden of establishing the existence of reasonable cause was on the executors and the finding of fact that this was not established is not clearly erroneous and should not be disturbed on appeal.

The evidence fully supports the District Court's findings. In each case, the record shows that the executors knew that estate tax returns had to be filed and that estate taxes would have to be paid. It also establishes that the executors in each case did no more than hire an attorney to handle the affairs of the estate. Thereafter, they failed to act with any diligence whatever concerning the filing of the required returns. They did not endeavor to ascertain whether the attorney was preparing the returns for filing or had in fact filed the returns. The District Court, having the opportunity to observe the witnesses as they testified, acted well within its discretion in remaining unconvinced by the witnesses in their attempts to show ignorance about matters relating to the filing of the returns.

These are not cases like those in which it has been held that *bona fide* reliance on the advice of competent tax counsel to the effect that tax returns are not required under the law constitutes reasonable cause. Rather, in these cases, where there was knowledge that returns were required, the delays of over sixteen months in one case and over six months in the other can not be explained away by merely alleging that the task of preparing and filing the returns was delegated to another. A period of fifteen months after the death of a decedent is allowed for filing an estate tax return. Congress has provided for additions to tax when the return is not timely filed. In order to avoid the imposition of these additions, reasonable cause for the delay must be established. It can not be said that one acts with reasonable business care and prudence (the standard for determining whether reasonable cause exists) when he merely delegates the responsibility of filing the return to another and thereafter does no more. The duty owed the United States is greater than that. In so holding, the District Court was correct and should be affirmed.

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### ARGUMENT.

**THE DISTRICT COURT CORRECTLY HELD THAT THE EXECUTORS' FAILURE TO FILE ESTATE TAX RETURNS WITHIN THE TIME REQUIRED WAS DUE TO WILFUL NEGLECT RATHER THAN REASONABLE CAUSE.**

The decedent, Luigi Ferrari, died on August 2, 1946. (R. 25, No. 15,257.) Under the applicable law and Regulations, a federal estate tax return for his



estate was due to be filed within fifteen months from the date of his death. (November 2, 1947.) Section 821, Internal Revenue Code of 1939 (Appendix, *infra*), and Section 81.63, Treasury Regulations 105, promulgated under the Internal Revenue Code of 1939. A one-month extension of the time in which the return was required to be filed was granted, so that the return was due on December 2, 1947. The return was not filed until April 22, 1949, over sixteen months late. (R. 25, No. 15,257.)

The decedent, Mario Ferrando, died on April 20, 1947. (R. 21-22, No. 15,256.) Under the applicable Regulations, a federal estate tax return for his estate was similarly due to be filed within fifteen months from the date of his death. (July 20, 1948.) The return was not filed until February 7, 1949. (R. 22, No. 15,256.)

The District Court found that, in each of the cases, the failure to file the estate tax returns within the prescribed time was not due to reasonable cause, but to wilful neglect and that additions to tax pursuant to Section 3612(d)(1) of the Internal Revenue Code of 1939 (Appendix, *infra*), were properly imposed. (R. 23, 24, 25, No. 15,256; R. 26, 27, 28, No. 15,257.)

Whether the failure to file tax returns within the time required by law is due to reasonable cause rather than wilful neglect is a question of fact which is primarily for the decision of the trier of fact, the District Court. The burden of establishing the existence of "reasonable cause" is on the taxpayers. *Coates v. Commissioner*, 234 F. 2d 459 (C.A. 8th); *Sanders v.*



*Commissioner*, 225 F. 2d 629, 637 (C.A. 10th); *Lee v. Commissioner*, 227 F. 2d 181, 184 (C.A. 5th). In these cases, the executors have not carried that burden to the satisfaction of the District Court. Rather, the District Court, which had the opportunity of seeing and hearing the witnesses as they testified, decided in each case that there had been no showing that the failure to file the estate tax returns of the two decedents was due to reasonable cause rather than wilful neglect. (R. 17-20, No. 15,256; R. 20-22, No. 15,257.) The District Court's findings in this connection should not be disturbed unless clearly erroneous. Rule 52(a), Federal Rules of Civil Procedure; *United States v. Yellow Cab Co.*, 338 U.S 338; *Pacific Homes v. United States*, 230 F. 2d 755 (C.A. 9th). And, we submit, that not only are the findings of the District Court not clearly erroneous, but that they are amply supported by the evidence and should be affirmed.

#### **Ferrando Estate.**

The District Court found that the executors of the Ferrando estate made no attempt to become familiar with their duties and obligations as executors and that they knew that an estate tax return must be filed and a tax was required to be paid. (R. 22, No. 15,256.) It also found that they made no attempt to determine whether their attorney filed an estate tax return within the prescribed period. (R. 23, No. 15,256.) These findings, in themselves, support the finding that the failure to file the return, within the period allowed, and the filing of the return more than six months after the expiration of that period, was

due to wilful neglect rather than reasonable cause. That these are proper findings is clear from the evidence.

Fred Ferrando was a businessman and was generally familiar with the requirements of state and federal law that tax returns were required to be filed at a designated time. (II R. 35, 41-43.)<sup>1</sup> When he hired the attorney, Cosgrove, he did not hire him as a tax expert. (II R. 43, 44.) They conversed about the estate tax liability within a week after the death of the decedent. (II R. 37, 43.) And Ferrando knew that taxes would have to be paid on his father's estate. (II R. 45.) But, in spite of this knowledge, Ferrando made no effort to ascertain his responsibilities in connection with the estate. Cosgrove did not outline any of the procedures that would have to be taken (II R. 66) and Ferrando made no inquiries of anyone else. (II R. 44.) When asked whether he knew that there was a fifteen-month period within which a return had to be filed, he answered (II R. 44) "No, I don't remember; I don't remember." He replied in the same manner, when asked if he questioned Cosgrove as to when an estate tax return would be due. (II R. 44.) However, he recalled that an inventory appraisal in connection with the estate had been filed on October 14, 1948 (II R. 45-46), but did not remember whether he asked Cosgrove at that time about the filing of the federal estate tax return. He said (II R. 46) "I know this, that I had called him on the telephone and asked

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<sup>1</sup>References to the transcript of testimony in both cases are cited (II R.     ).

him if the estate was finished yet and he said everything is being taken care of. *I just left it at that.*" (Emphasis supplied.)

We submit that it is not an exercise of reasonable business care and prudence to take such a haphazard approach to one's responsibilities and duties as an executor. And particularly when it is noted that on the crucial matters relating to the federal estate tax return and taxes Mr. Ferrando had no memory whatever, it was well within the discretion of the District Court, which observed him as he testified, to refuse to believe the testimony relating to his ignorance of these matters.<sup>2</sup> *Showell v. Commissioner*, 238 F. 2d 148, 152 (C.A. 9th), rehearing denied, 238 F. 2d 155. The District Court's findings that the failure to file the estate tax return within the required time was not due to reasonable cause, but was due to wilful neglect are fully supported by the evidence and should not, therefore, be upset.

#### **Ferrari Estate.**

In the *Ferrari* case, the District Court made findings similar to those in the *Ferrando* case. (R. 24-28, No. 15,257.) The claim of the executors in this case is that they signed what purported to be an estate tax return on October 31, 1947, prior to the time that

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<sup>2</sup>The estate tax return was filed on February 7, 1949, but was dated July 15, 1948. A check for the taxes, written in February, 1949, was dated July 15, 1948, but the date was not put on by Ferrando. He testified that although it was not his practice to omit the date when writing checks, he did so in this instance but again could not remember why. (II R. 47-49, 51, 53-54.) This, in itself, casts some doubt on the reliability of his testimony, which the District Court could have taken into account.

it was due. The District Court, however, in response to this contention stated (R. 22, No. 15,257):

But, their testimony on this point is so equivocal and lacking in forthrightness that it is unacceptable. The only conclusion that can be drawn from the record made is that plaintiffs have failed to sustain the burden of showing that the delinquent filing was due to reasonable cause and not to wilful neglect.

The reasonableness of this statement by the District Court is shown by the fact that the executors' contention is contradicted by other evidence in the record.<sup>3</sup>

Although George Ferrari testified that he signed "estate tax papers" (II R. 180) (intending to convey the impression that he thought a return had been filed) and was told by Cosgrove that "the time was almost up" (II R. 179), when a neighbor told him about the fifteen-month limitation for filing the return in 1948 (after the return was due), he immediately went to Cosgrove's office to inquire about the fifteen-month period. (II R. 188.) It is obvious that there would have been no need for this concern, if Mr. Ferrari had an honest belief that he had filed the return in October, 1947. Furthermore, although Ferrari admitted (II R. 196) that Cosgrove told him, in 1947, that he was going to get an extension of time (which Ferrari claimed he thought was an extension of time in which to pay the tax), he did not ask if an

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<sup>3</sup>The District Court, in its opinion, refers to the fact that an extension of time was secured until December 2, 1949. (R. 20, 21, No. 15,257.) This is apparently a typographical error. Its findings (R. 25, No. 15,257) show the proper date, December 2, 1947.



extension was in fact secured or, if so, how long an extension was granted. (II R. 196-198.) The tax was not paid or the return filed until April, 1949. (R. 25, No. 15,257; II R. 122, 143, 200.) This too shows a lack of reasonable care on the part of the executors. Still another indication that the contention that the Ferraris believed that a return was filed in 1947 is not valid is found in the fact that it was only sometime in 1949 when the executors first became concerned over the payment of the tax. (II R. 200.) But the executors purportedly knew in 1947 that the estate tax due would be around \$100,000. (II R. 179, 217.) And, like the executors in the Ferrando case, the executors of the Ferrari estate did not ask Cosgrove whether a return was filed. (II R. 130.)

Certainly in the light of this evidence, the District Court was more than justified in exercising its "right to remain unconvinced" by the testimony offered on behalf of the Ferrari estate.<sup>4</sup> *Showell v. Commissioner*, *supra*. The record presents a picture of confusion from which only one valid conclusion can be drawn—the failure to file the estate tax return for the decedent Ferrari was due to wilful neglect and not reasonable cause. We submit that the District Court's findings to this effect are the only ones that could be made on this record and must be sustained.

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<sup>4</sup>The District Court was entitled to disregard any of the testimony of the attorney, Cosgrove, since he has a substantial financial interest in the outcome of the litigation. Having agreed to reimburse the executors for any losses they will incur as a result of the imposition of additions to tax for late filing of the returns (II R. 80-81, 124-125), it was to his personal advantage to be as favorable to the estates as possible in his testimony.



The contention of the executors is that their reliance on their attorney, Lloyd Cosgrove, absolves them of all liability for the failure to file the estate tax returns of their decedents within the time prescribed by the Code and Regulations. They cite in support of their argument (Br. 27) *Fisk v. Commissioner*, 203 F. 2d 358 (C.A. 6th). But an examination of this case will reveal immediately that the situations are not analogous. The estate tax return in the *Fisk* case was mailed on the date that it was due and received by the Collector only *one day* late, while the returns in these cases were filed over *sixteen months* late in the *Ferrari* case and over *six months* late in the *Ferrando* case. It is at once obvious that, while a delay of one day in certain circumstances might be regarded as reasonable, delays of sixteen months and six months can not be viewed in the same light.<sup>5</sup>

Neither are these cases similar to those, cited by the executors, in which taxpayers, faced with complicated problems of ascertaining whether they came under special statutory provisions (such as the personal holding company section of the Code), relied upon advice of counsel to the effect that they were not required to file returns. Cf. *Hatfried, Inc. v. Commissioner*, 162 F. 2d 628 (C.A. 3d); *Haywood Lumber & Min. Co. v. Commissioner*, 178 F. 2d 769 (C.A. 2d).

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<sup>5</sup>Compare *Cronin's Estate v. Commissioner*, 164 F. 2d 561, 566, where the Sixth Circuit held that reasonable cause for late filing of an estate tax return was not established by a claim that the data for the return could not be assembled because of the illness of the decedent's secretary and that the estate's attorney did not know of the time limit for filing returns.

In such circumstances, it has been held that *bona fide* reliance on the advice of competent tax counsel as to whether returns were required to be filed constituted reasonable cause.<sup>6</sup> No such reliance exists in the cases at bar. There was no doubt that estate tax returns were required and there is no evidence that the executors' counsel advised them that returns were not required. On the contrary, the whole theory of the executors' cases is that they were aware that they were required to file estate tax returns. In these circumstances, they are responsible for the negligence of the person to whom they delegated their duties. *Berlin v. Commissioner*,<sup>7</sup> 59 F. 2d 996 (C.A. 2d), certiorari denied, 287 U.S. 642.

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<sup>6</sup>It should be noted, however, that the advice of the tax adviser must be formally sought and that consideration to the problem of whether returns were required must have been given by the tax adviser. Cf. *Credit Bureau of Greater N. Y. v. Commissioner*, 162 F. 2d 7, 9 (C.A. 2d). A statement that tax matters were left to an accountant is not a sufficient showing of reasonable cause to avoid the imposition of additions to tax. *Home Guaranty Abstract Co. v. Commissioner*, 8 T.C. 617, 622.

<sup>7</sup>The *Berlin* case held that a taxpayer who relied upon a tax adviser to file his income tax returns took the benefits of his agent's actions in his behalf "*cum onere* and \* \* \* [was] chargeable with any willful neglect ascribable to his agent." 59 F. 2d 996, 997. This holding was modified somewhat in a later case (*Haywood Lumber & Min. Co. v. Commissioner*, 178 F. 2d 769 (C.A. 2d)), but only as regards "cases which hold that advice sought and received in good faith from a competent adviser constitutes reasonable cause for failure to file the required return \* \* \*". 178 F. 769, 771. As pointed out above, these cases are not like such a case but rather are situations exactly parallel to the *Berlin* case. See also *Woolsey v. United States*, 138 F. Supp. 952 (N.D. N.Y.), affirmed *per curiam*, 230 F. 2d 948 (C.A. 2d), certiorari denied, 352 U.S. 832.

In the final analysis, the issue in these cases is whether a person charged with the duty of filing returns and knowing that he has this duty can relieve himself of any responsibility for an untimely filing by delegating it to another. These cases present extreme examples. For, here, once counsel had been hired for the estates the executors apparently went their own way, without regard to whether the attorney was properly handling their affairs.<sup>8</sup> There is not even any evidence that inquiries were made by the executors as to whether the returns were filed. Certainly, such action cannot be deemed "reasonable cause". The care required by the statute is reasonable business care and prudence. *Sanders v. Commissioner*, 225 F. 2d 629, 636-637 (C.A. 10th). And, we submit, that the duty owed the United States by its taxpayers is

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<sup>8</sup>A reading of the record establishes beyond a doubt that the attorney for the estates involved did not exercise reasonable care as regards the filing of the returns. Similarly, the record shows that the actions of the executors were also not the exercise of reasonable business care and prudence. The only question in this case is whether the failure to file the returns within the allowed period was, in fact, reasonable. To know or to learn that an estate tax return is due within fifteen months of the decedent's death does not call for the exercise of technical skill or complicated tax knowledge. And as the District Court said (R. 19, No. 15,256):

\* \* \* in these days when the filing of a variety of tax returns is a commonplace experience, it is not asking too much of an executor, who is aware that an estate tax must be paid, that he ascertain the time when the return and the tax are due. Ordinary prudence demands that he do so, for he must make sure that the necessary information and funds are available for a timely filing of the return and payment of the tax. Plaintiffs' neglect of this responsibility permitted their attorney to push aside the work of preparing and filing the estate tax return in favor of more pressing matters. Attentiveness on the part of plaintiffs would have prompted a timely filing.

not reasonably exercised by merely delegating to another the responsibility for seeing that the duty is carried out. *Home Guaranty Abstract Co. v. Commissioner, supra; Davenport v. Commissioner*, 6 T.C. 62, 67. In recognizing this and giving effect to the mandate of Congress, the District Court was correct and should be affirmed.

---

### CONCLUSION.

For the reasons stated the judgments of the District Court should be affirmed.

Respectfully submitted,

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Assistant United States Attorney.

March, 1957.

(Appendix Follows.)





## **Appendix.**



## Appendix

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Internal Revenue Code of 1939:

### SEC. 821. RETURNS.

#### (a) *Requirement.*—

(1) *Returns by executor.*—In all cases where the gross estate at the death of a citizen or resident exceeds the amount of the specific exemption provided in section 812 (a), the executor shall make a return under oath in duplicate, setting forth (1) the value of the gross estate of the decedent at the time of his death; (2) the deductions allowed under section 812; (3) the value of the net estate of the decedent as defined in section 812; and (4) the tax paid or payable thereon; or such part of such information as may at the time be ascertainable and such supplemental data as may be necessary to establish the correct tax.

\* \* \*

(b) *Time for Filing.*—The return required of the executor under subsection (a) shall be filed at such times and in such manner as may be required by regulations made pursuant to law.

\* \* \*

(26 U.S.C. 1952 ed., Sec. 821.)

### SEC. 3612. RETURNS EXECUTED BY COMMISSIONER OR COLLECTOR.

\* \* \*

#### (d) *Additions to Tax.*—

(1) *Failure to file return.*—In case of any failure to make and file a return or list within

the time prescribed by law, or prescribed by the Commissioner or the collector in pursuance of law, the Commissioner shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to wilful neglect, no such addition shall be made to the tax: *Provided*, That in the case of a failure to make and file a return required by law, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, if the last date so prescribed for filing the return is after August 30, 1935, then there shall be added to the tax, in lieu of such 25 per centum: 5 per centum if the failure is for not more than 30 days, with an additional 5 per centum for each additional 30 days or fraction thereof during which failure continues, not to exceed 25 per centum in the aggregate.

\* \* \*

(26 U.S.C. 1952 ed., Sec. 3612.)

No. 15264

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United States  
Court of Appeals  
for the Ninth Circuit

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ORION SHIPPING AND TRADING COM-  
PANY, a corporation, and PACIFIC CARGO  
CARRIERS CORPORATION,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

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Transcript of Record

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Appeal from the United States District Court for the  
Western District of Washington  
Northern Division

FILED

JAN 21 1957

PAUL P. O'BRIEN, CLERK





No. 15264

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United States  
Court of Appeals  
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In the United States District Court for the  
Eastern District of Pennsylvania

Civil Action No. 3791

WILLIE B. BASNIGHT,

vs.

ORION SHIPPING & TRADING COMPANY,  
INC. PACIFIC CARGO CARRIERS COR-  
PORATION

Action by Seaman Without Prepayment  
of Costs, 28 U.S.C.A. Sec. 1916

COMPLAINT

Jury Trial Demanded

Plaintiff, Willie B. Basnight, claims of Orion Shipping & Trading Company, Inc., and Pacific Cargo Carriers Corporation, defendants, the sum of Twenty-Five Thousand (\$25,000.00) Dollars, with lawful interest thereon, upon a cause of action whereof the following is a true statement:

1. Plaintiff, Willie B. Basnight, at all times mentioned herein, was a seaman in the United States Merchant Marine.

2. Defendants, Orion Shipping & Trading Company, Inc., and Pacific Cargo Carriers Corporation, are corporations duly organized and existing under and by virtue of the laws of the State of Delaware.

3. Plaintiff, upon information and belief, avers

that at all times mentioned herein, defendants possessed, owned, operated and controlled the S.S. "Seacoronet", engaged in coastwise, intercoastal and foreign commerce.

4. On or about the 17th day of August, 1953, and at all times mentioned herein, plaintiff was employed as a member of the crew of the S.S. "Seacoronet" in the capacity of Bedroom Utility at the rate of \$242.32 per month, plus overtime, on a foreign voyage for a period not exceeding twelve calendar months.

5. On or about the 17th day of August, 1953, at or about 10:30 p.m., plaintiff, while engaged in the performance of his duties on the vessel at Pusan, Korea, was suddenly and without warning exposed to chlorine gas or other noxious and poisonous fumes and gasses, as a result of which he sustained the injuries which are hereinafter more specifically set forth.

6. Disregarding their duties in the premises, defendants, by their agents, servants and employees, were careless and negligent and the vessel was unseaworthy in:

(a) failing to provide a reasonably safe place for the performance of plaintiff's work;

(b) failing to make a proper and adequate inspection to determine the existence of any unsafe conditions under the circumstances;

(c) causing and permitting the aforesaid chlorine gas or other noxious and poisonous fumes and gasses to escape and affect the plaintiff;

(d) failing to properly and adequately supervise and inspect the stowage of cargo;

(e) failing to warn plaintiff of the escape and presence of said poisonous gasses and to provide adequate safety devices under the circumstances;

(f) failing to provide a safe and seaworthy vessel and appurtenances and keep same in a safe and seaworthy condition;

(g) failing to provide proper and adequate medical and attention and maintenance for the alleviation cure of plaintiff's injuries.

7. During the entire period plaintiff was employed, he well and truly performed all his duties and was obedient to all lawful commands of the master and other officers of the vessel.

8. Solely by reason of the negligence of the defendants and the unseaworthiness of the vessel, plaintiff was then and there generally wounded; his lungs, bronchial tubes and respiratory organs, and the muscles, nerves and ligaments attached thereto were severely wrenched, bruised, torn, fractured and otherwise injured; he sustained a severe paroxysmal cough, hoarseness and dyspnea; he sustained a tracheal bronchitis; he sustained impairment of the vital capacity of his lungs; he sustained a shock to his nervous system; he has suffered excruciating and agonizing aches, pains, mental anguish, shock and disability; he has been unable to assume his usual duties and occupation for a long period of time in the past, and upon information, believes and therefore avers that his condition has become aggravated and that he will be unable to



perform his usual duties for a long period of time in the future; he has in the past and will be in the future be compelled to expend large sums of money for medicine, medical care and treatment.

Wherefore, Willie B. Basnight claims the sum of Twenty-Five Thousand (\$25,000.00) Dollars and brings this action to recover same from the defendants.

FREEDMAN, LANDY AND LORRY  
/s/ By WILLIAM N. ALPER  
Attorneys for Plaintiff

[Endorsed]: Filed September 20, 1954.

---

In the United States District Court, Western  
District of Washington, Northern Division

No. 3623

CHARLES E. AREGOOD,                      Plaintiff,

vs.

ORION SHIPPING AND TRADING COM-  
PANY, a corporation,

Defendant and Third Party Plaintiff,

vs.

UNITED STATES OF AMERICA,

Third Party Defendant.

MOTION TO DISMISS THIRD PARTY  
COMPLAINT GRANTED

Now on this 6th day of December, 1954, Leonard  
Ware appears for the Government. Cause comes on

before the Court on motion of third party defendant to dismiss third party complaint under Rule 12(d) FRCD. Cause is called and granted.

Journal No. 48, page 309.

Certification Attached.

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United States District Court Western  
District of Washington, Northern Division

Civil Action No. 3791

WILLIE B. BASNIGHT, Plaintiff,

vs.

ORION SHIPPING & TRADING COMPANY,  
INC., and PACIFIC CARGO CARRIERS  
CORPORATION,

Defendants and Third Party Plaintiffs,

vs.

UNITED STATES OF AMERICA,  
Third Party Defendant.

### THIRD PARTY COMPLAINT

The Orion Shipping and Trading Company, third party plaintiff, complaining of the United States of America, third party defendant, alleges upon information and belief as follows:

#### I.

That all times hereinafter mentioned the third party plaintiff was and is a foreign corporation organized and existing under the laws of the State

of New York, and at all times herein mentioned was and is doing business within the jurisdiction of this court.

## II.

At all times hereinafter mentioned, the United States of America was and is a sovereign power and is sued herein under and by virtue of the provisions of the Federal Tort Claims Act, Title IV, Chapter 753—Public Law 601—Legislative Reorganization Act of 1946, the Suits in Admiralty Act, 46 U.S.C.-A.P. 741—752, and other applicable Federal Statutes.

## III.

The plaintiff, Willie B. Basnight, has filed a complaint, copy of which is hereto annexed and marked Exhibit "A", against the defendants and third party plaintiffs, Orion Shipping & Trading Company, Inc., and Pacific Cargo Carriers Corporation, to recover damages for injuries sustained by him on the 17th day of August, 1953, while employed by the defendants and the third party plaintiffs. The complaint alleges that the plaintiffs, Willie B. Basnight, was severely injured while employed aboard the S.S. Seacoronet as a Bedroom Utility.

## IV.

That at all times material herein the S.S. Seacoronet was being operated as a merchant vessel of the United States carrying government cargo.

## V.

The complaint of the plaintiff, Willie B. Bas-

night alleges that on or about the 17th day of August, 1953 at or about 10:30 P.M., plaintiff, while engaged in the performance of his duties on the vessel at Pusan, Korea, was suddenly and without warning exposed to chlorine gas or other noxious and poisonous fumes and gasses, as a result of which he sustained certain injuries. The complaint further states that disregarding their duties in the premises, defendants, by their agents, servants and employees, were careless and negligent and the vessel was unseaworthy in failing to provide a reasonably safe place for the performance of plaintiff's work, in failing to make a proper and adequate inspection to determine the existence of any unsafe conditions under the circumstances, in causing and permitting the aforesaid chlorine gas or other noxious and poisonous fumes and gasses to escape and affect the plaintiff, in failing to properly and adequately supervise and inspect the stowage of cargo, in failing to warn plaintiff of the escape and presence of said poisonous gasses and to provide adequate safety devices under the circumstances, in failing to provide a safe and seaworthy vessel and appurtenances and to keep same in a safe and seaworthy condition, and in failing to provide proper and adequate medical care and attention and maintenance for the alleviation and cure of plaintiff's injuries. The plaintiff claims that solely by reason of the negligence of the defendants and the unseaworthiness of the vessel, plaintiff was then and there generally wounded; his lungs, bronchial tubes and respira-

tory organs, and the muscles, nerves and ligaments attached thereto were severely wrenched, bruised, torn, fractured and otherwise injured; he sustained a severe paroxysmal cough, hoarseness and dyspnea, he sustained a tracheal bronchitis; he sustained impairment of the vital capacity of his lungs; he sustained a shock to his nervous system; he has suffered excruciating and agonizing aches, pains, mental anguish, shock and disability; he has been unable to assume his usual duties and occupation for a long period of time in the past, and upon information, believes and therefore avers that his condition has become aggravated and that he will be unable to perform his usual duties for a long period of time in the future; he has in the past and will in the future be compelled to expend large sums of money for medicine, medical care and treatment.

## VI.

The said injuries of the plaintiff, Willie B. Basnight, were sustained solely and entirely as a result of the negligence of United States of America, the third party defendant, and that, if the defendants and third party plaintiffs, Orion Shipping & Trading Company and Pacific Cargo Carriers Corporation, are held responsible to the plaintiff, Willie B. Basnight, such responsibility arose solely out of the acts and conduct of the third party defendant, United States of America, and/or its agents, servants, or employees, in connection with the loading operations aboard the vessel being conducted at said time and place, and more particularly in the



negligence and carelessness of the third party defendant United States of America in loading aboard the vessel a cylinder or cylinders filled with chlorine gas, and more particularly in treating said cylinders as a part of the scrap metal being loaded aboard the vessel and failing therefore to take the proper precautions to prevent the escape of chlorine gas.

## VII.

The third party plaintiff further alleges that the third party defendant, United States of America, was negligent in failing to maintain a proper security watch at or near the scene of its cargo loading operations such that an appropriate alarm could have been given following the release of said chlorine gas in time to warn the members of the crew of the vessel and to prevent their exposure to said chlorine gas fumes.

## VIII.

That as a result of the negligence and carelessness of the third party defendant, United States of America, as aforesaid, the third party plaintiffs are entitled to be indemnified for any recovery that may be had against them by Willie B. Basnight, plaintiff, together with expenses if any in this action.

Wherefore, Orion Shipping & Trading Company and Pacific Cargo Carriers Corporation demand judgment against the third party defendant United States of America for all sums that may be adjudged against the defendants Orion Shipping & Trading Company and Pacific Cargo Carriers Cor-

poration in favor of the plaintiff, Willie B. Basnight.

BOGLE, BOGLE & GATES,  
Attorneys for Defendants and Third  
Party Plaintiffs.

Duly Verified.

(Complaint is set out at pages 3-6 of this  
printed record.)

[Endorsed]: Filed April 11, 1955.

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[Title of District Court and Cause No. 3791.]

MOTION TO DISMISS THIRD PARTY COM-  
PLAINT UNDER RULE 12(d) FEDERAL  
RULES OF CIVIL PROCEDURE

Comes now third party defendant United States of America and moves the Court to dismiss the third party complaint on file herein upon the following grounds:

I.

That the third party complaint fails to state a claim against third party defendant United States of America upon which relief can be granted.

II.

That the Court lacks jurisdiction of third party plaintiff's alleged claim in that the Federal Tort Claims Act, 28 U.S.C. 1346(b), 2671 et seq., upon which plaintiff's claim is alleged to be founded, does not confer jurisdiction upon this Court, third party plaintiff's alleged claim having arisen in a

foreign country and being therefore a claim excepted from the Federal Tort Claims Act by 28 U.S.C. 2680(k) thereof.

### III.

That the Court lacks jurisdiction of third party plaintiff's alleged claim in that the Suits in Admiralty Act, 46 U.S.C. 741 et seq., upon which plaintiff's claim is alleged to be founded, does not confer jurisdiction upon this Court in an action at law.

### IV.

That third party plaintiff has failed to allege facts showing that the venue is properly laid in the Western District of Washington.

### V.

That third party plaintiff has filed its third party complaint as a civil action on a tort claim against the United States under 28 U.S.C. 1346(d); that third party plaintiff does not reside in the Western District of Washington; that the act complained of did not occur in the said District; and that the venue of the said third party complaint is therefore, under 28 U.S.C. 1402(b), improperly laid in the Western District of Washington.

### VI.

That third party plaintiff has filed its third party complaint on a claim against the United States, purportedly under the Suits in Admiralty Act, 46 U.S.C. 741 et seq.; that plaintiff does not reside or have its principal place of business in the Western District of Washington; that the cargo sought to

be charged the liability is not found in the said District; and that the venue of the said third party complaint is therefore, under 46 U.S.C. 742, improperly laid in the Western District of Washington.

VII.

That the third party complaint fails to state any cause of indemnity against third party defendant United States of America and a cause of indemnity, if stated, would be improperly brought under the Federal Tort Claims Act.

/s/ CHARLES P. MORIARTY,

United States Attorney,

/s/ FRANK N. CUSHMAN,

Assistant United States Attorney,

/s/ KEITH R. FERGUSON,

Special Assistant to the Attorney  
General,

Attorneys for Third Party  
Defendant

Acknowledgment of Receipt of Copy Attached.

[Endorsed]: Filed June 15, 1955.

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[Title of District Court and Cause No. 3791.]

AFFIDAVIT OF KEITH R. FERGUSON

United States of America

Northern District of California—ss.

Keith R. Ferguson being duly sworn, upon oath deposes and says:

That he is one of the attorneys for third party de-

fendant United States of America in this case, and as such states on the basis of information officially furnished to him,

That the attached photostatic copy of the Certificate of Second Lieutenant Robert E. Baynard, United States Army, photostatic copy of the Army Ocean Manifest and photostatic copies of two Army shipping documents, are true copies of original documents in the files of the United States Army, indicating that the chlorine flasks referred to in the third party complaint herein were loaded aboard the SS. Sea Coronet at Pusan, Korea for shipment as scrap metal to Yokohama, Japan, and that the said chlorine flasks and all of them were duly received and discharged at Yokohama, Japan.

/s/ KEITH R. FERGUSON

Subscribed and sworn to before me this 10th day of June, 1955.

[Seal] /s/ E. H. NORMAN,  
Deputy Clerk of the District Court, Northern District of California.

Acknowledgment of Service Attached.

EXHIBIT "Y"

Headquarters

7th Transportation Major Port

Port Transportation Division

APO 59

CERTIFICATE

I, Robert E. Baynard, 2/Lt QMC, have been associated with the Documentation Section, Port Trans-



portation Division, 7th Transportation Major Port since 10 July 1953 and have personal knowledge of the enclosed documents.

Attached hereto are extract true copies of the Army Ocean Manifests and Army Shipping Documents relating to the gas tanks loaded aboard the SS Sea Coronet on 18 August, 1953 at Quay 2, Berth 13, at this port. The "Pier Operations" Section of the Army Shipping Documents have the names of the Korean checkers who received and tallied aboard this cargo. The ASD's were prepared by the Documentation Section from the outbound hatch tallies.

The outturn report from the 2nd Transportation Major Port makes no mention of these gas tanks which indicates they were received as manifested. Port records do not indicate whether subject tanks arrived in the same or different rail shipments.

/s/ Robert E. Baynard,  
2/Lt            QMC  
OIC, Documentation Section

[Endorsed]: Filed June 15, 1955.

UNIT	S/S SEA ORCHET	FROM	I S U P	TO	E V I L	QUANTITY AND ITS PKGS.	CONSIGNEE	DESCRIPTION	WFOHT	CAN	PAYMENT
6611-A CTRLO	MAINTENANCE DIVISION CLASSIFICATION BRANCH BELL-DAY-TREED AREA AL STATION	18 EA	GAS TANK						37000	594.0	5 L/H
6616	YOUNG & ENGINEER DEPT	4 Pos	GAS TANK						6000	128.0	4 L/H
		373 Pos				Total Rt and Co			292161	16587.4	
						Total Lt and Mt			130.4	444.7	

A: TRUE EXTRACT COPY  
*Ralph E. Hayward*  
RALPH E. HAYWARD  
2ND LT  
CMC

(73)









575

STATION		DATE		TIME		WIND		TEMP		HUMID		PRESS		VISIB		SEA		SKY		CLOUDS		REMARKS	
NO.	NAME	DAY	MONTH	HOUR	MIN	DIR	SPD	WAV	WAV	WAV	WAV	WAV	WAV	WAV	WAV	WAV	WAV	WAV	WAV	WAV	WAV	WAV	
552ND ENGINEER BASE DEPOT AFC 973																							
YOKOHAMA ENGINEER DEPOT																							
6413-A																							
STATION NO.																							
DESCRIPTION OF ARTICLE																							
GAS TANK																							
A: CERTIFIED TRUE COPY																							
ROBERT E. BATHARD																							
2ND LG																							
ALL SURVIVORS																							
CHINESE LAK NROB																							
19th Aug 53																							
04-2 803																							
19 AUG 53																							
CHINESE LAK NROB																							
S/S SEA ORCHARD																							
HPL L/H																							
REMARKS																							
6413-A																							

Exhibit Y  
(continued)



[Title of District Court and Cause No. 3623.]

ORDER ON THIRD PARTY DEFENDANT'S  
MOTION TO DISMISS THIRD PARTY  
COMPLAINT UNDER RULE 12(d)

The third party defendant's motion to dismiss the third party complaint under Rule 12 (d) having come on regularly for hearing on the 19th day of September, 1955, and

The defendant and third party plaintiff's motion to file an amended third party complaint having previously thereto been granted, and

The court having considered the thirty party defendant's motion to dismiss as also being one against the amended third party complaint, and

The plaintiff being represented by Mr. Edwin J. Friedman, the defendant being represented by Mr. Robert V. Holland and the third party defendant being represented by Mr. Frank Cushman, and Graydon Staring, and the court having heard argument of counsel and being fully advised in the premises; now, therefore

It Is Hereby Ordered, Adjudged and Decreed that the third party defendant's motion to dismiss third party complaint and amendment thereto be and the same hereby is denied.

It Is Further Ordered that the third party defendant is given leave on the trial of the cause to renew said motion.

Done In Open Court this 6th day of October,  
1955.

/s/ JOHN C. BOWEN  
U. S. District Judge

Presented and approved by:

/s/ ROBERT V. HOLLAND  
Of Bogle, Bogle & Gates, Attorneys for Defendant  
and Third Party Plaintiff.

Approved:

/s/ EDWIN J. FRIEDMAN  
Of Levinson & Friedman  
Attorneys for Plaintiff

Approved:

/s/ F. N. CUSHMAN  
Assistant United State Attorney

[Endorsed]: Filed Oct. 6, 1955.

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[Title of District Court and Cause No. 3791.]

## ANSWER TO THIRD PARTY COMPLAINT

Comes now third party defendant United States of America and answering unto the third party complaint, admits, denies and alleges as follows:

### I.

Answering unto Paragraph I, third party defendant admits that Orion Shipping and Trading Company was and is a corporation organized and existing under the laws of the State of New York and denies all and singular the remaining allegations thereof.

## II.

Answering unto Paragraph II, third party defendant admits that it is a sovereign power. The remaining allegations of Paragraph II concern questions of law and do not require any answer of third party defendant.

## III.

Answering unto Paragraph III, third party defendant admits the allegations thereof.

## IV.

Answering unto Paragraph IV, third party defendant admits the allegations thereof.

## V.

Answering unto Paragraph V, third party defendant admits the allegations thereof except the allegations of the complaint described therein, as to which no answer by third party defendant is required.

## VI.

Answering unto Paragraph VI, third party defendant denies all and singular the allegations thereof.

## VII.

Answering unto Paragraph VII, third party defendant denies all and singular the allegations thereof.

## VIII.

Answering unto Paragraph VIII, third party defendant denies all and singular the allegations thereof.



Wherefore, third party defendant prays that the third party complaint herein be dismissed and judgment entered for the United States of America with costs.

/s/ CHARLES P. MORIARTY

United States Attorney

/s/ FRANK N. CUSHMAN

Assistant United States Attorney

/s/ KEITH R. FERGUSON

Special Assistant to the Attorney  
General

/s/ GRAYDON S. STARING

Attorney, Department of Justice

Attorneys for Third Party De-  
fendant United States of  
America

Acknowledgment of Service Attached.

[Endorsed]: Filed Oct. 7, 1955.

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[Title of District Court and Cause No. 3791.]

### ANSWER

Comes now the defendants and for answer to the complaint of the plaintiff on file herein admit, deny and allege as follows:

#### I.

Answering Paragraph I, defendants admit the same.

#### II.

Answering Paragraph 2, defendants deny the same.

III.

Answering Paragraph 3, defendants admit the same.

IV.

Answering Paragraph 4, defendants admit the same.

V.

Answering Paragraph 5, defendants admit the escape of gas on the vessel at the time and place mentioned. Defendants deny each and every other allegation therein contained.

VI.

Answering Paragraph 6, defendants deny the same.

VII.

Answering Paragraph 7, defendants deny the same.

VIII.

Answering Paragraph 8, defendants deny the same.

Wherefore, having fully answered the complaint of the plaintiff, defendants pray that they may be dismissed and recover their costs and disbursements herein to be taxed.

BOGLE, BOGLE & GATES,  
Attorneys for Defendants.

Duly Verified.

Acknowledgment of Service Attached.

[Endorsed]: Filed April 13, 1956.

[Title of District Court and Cause No. 3791.]

REQUEST FOR ADMISSION OF FACTS AND  
GENUINENESS OF DOCUMENTS

To: Orion Shipping and Trading Company, Inc.  
and Bogle, Bogle and Gates and Robert V. Hol-  
land, Esquire, its attorneys:

Please Take Notice that third party defendant hereby requests third party plaintiff, pursuant to Rule 36 and Rule 37 (c) of the Federal Rules of Civil Procedure to admit within 10 days after service of this request, the genuineness of the following documents:

I.

The photostatic copy of the Certificate of Second Lieutenant Robert E. Baynard, United States Army, which is attached to the Affidavit of Keith R. Ferguson filed herein June 15, 1955 and heretofore served upon you.

II.

The photostatic copy of the Army Ocean Manifest which is attached to the Affidavit of Keith R. Ferguson filed herein June 15, 1955 and heretofore served upon you.

III.

The photostatic copies of two Army Shipping Documents which are attached to the Affidavit of Keith R. Ferguson filed herein June 15, 1955 and heretofore served upon you.

Thirty Party Defendant further requests third party plaintiff to admit within the said period the truth of the following facts:

## IV.

Second Lieutenant Robert E. Baynard, United States Army, was, on August 16, 1953 and at all material times thereafter, associated with the Documentation Section, Port Transportation Division, 7th Transportation Major Port at Pusan, Korea.

## V.

Second Lieutenant Robert E. Baynard has personal knowledge of the original documents of which photostatic copies are referred to in II and III above.

## VI.

The 22 gas tanks listed in the documents referred to in II and III above included all chlorine flasks loaded aboard the Sea Coronet at Pusan on or about August 17, 1953.

## VII.

All the chlorine flasks loaded aboard the Sea Coronet at Pusan on or about August 17, 1953 were consigned to Yokohama or other points in Japan and were discharged by the Sea Coronet at Yokohama or other points in Japan.

## VIII.

None of the chlorine flasks loaded aboard the Sea Coronet at Pusan on or about August 17, 1953 was carried to or discharged in the United States by the Sea Coronet.

## IX.

None of the chlorine flasks loaded aboard the Sea Coronet at Pusan on or about August 17, 1953 was

at the time the third party complaint was filed herein, or has been since, located in the Western District of Washington.

X.

Orion Shipping and Trading Company, Inc. does not reside in the Western District of Washington.

XI.

Orion Shipping and Trading Company, Inc. does not have its principal place of business in the Western District of Washington.

Third Party Defendant further requests third party plaintiff to admit within the said period the genuineness of the following document:

XII.

Copy of "Notice of Damage to Vessel" dated 17 August 1953 and signed by the master of the SS Sea Coronet, attached hereto marked "Exhibit A".

/s/ CHARLES P. MORIARTY,

United States Attorney

/s/ F. N. CUSHMAN,

Assistant United States Attorney

/s/ KEITH A. FERGUSON,

Special Assistant to the Attorney  
General

/s/ GRAYDON S. STARING,

Attorney, Department of Justice

Attorneys for Third Party Defendant  
United States of America

Acknowledgment of Service Attached.



EXHIBIT A

Orion Shipping & Trading Co., Inc.  
80 Broad Street, New York 4, N. Y.

Report No. 31

Notice of Damage to Vessel While Under Charter  
to Military Sea Transportation Service

SS. Sea Coronet. Voy. #7. Port: Pusan.

Owner/Operator: Orion Shipping & Trading Co.

Date: 17 August, 1953.

Contract No. MST 1102.

a. This notice is to be signed by the Master.

b. Prior to departure this port, mail to Commander, Military Sea Transportation Service, Washington, D. C. Attn: Code 34.

c. If after diligent inquiry the name of the Contractor, agent or employee causing the damage is unknown, state "unknown". Korean Heavy Lift Corp.

1. Date of Damage: 17 August, 1953.

2. Port: Pusan.

3. Particulars of Damage. Carefully identify area, extent, frame Nos., etc. State your opinion of probable cause, reasons, etc. Indicate whether vessel incapacitated and to what degree. A complete statement is requested; use additional sheets and photographs where required. At 2230 this date one cylinder of Chlorine Gas was loaded on board this vessel. Cylinder was supposed to be empty. When lowered into No. 5 L. H. the gas escaped enveloping the entire vessel, causing evacuation order to be

given by order of the Master. Ship's plant secured. Damage not estimated at this time. See attached report.

4. Name of concern, person, etc., causing damage; also indicate name and address of person in charge of any work gangs concerned. Korean Heavy Lift Corp.

5. Witnesses (if none, state none). Seaman's Book No. or other identification: Z477999 D1. Name and address: Rudolph A. Henderson, Third Mate, 806 Center Dr., Baldwin Oaks, Baldwin, L. I.

6. Name of Chief Officer: Arthur G. Morriss. License No. 46281. Address: 2819 N.E. 69th Avenue, Portland 13, Oregon.

7. Did an MSTTS representative inspect the damage? If so, give his name and title. Was nearest MSTTS representative notified? Yes. Four copies this report delivered to MSTTS Pusan. Received notice: /s/ R. V. Hallowell, Ens., USNR.

I hereby certify that the information set out in the above Notice of Damage is correct to the best of my knowledge and belief.

N. Miller, Master.

[Endorsed]: Filed April 20, 1956.

[Title of District Court and Cause No. 3791.]

VERDICT FOR PLAINTIFFS

We, the jury in the above-entitled cause, find for the Plaintiff and assess Plaintiff's amount of recovery in the sum of Seven Thousand Nine Hundred and No/100 Dollars (\$7,900.00).

/s/ HAROLD J. CREEVEY,  
Foreman

Entered judgment on verdict in Civil Docket  
June 4, 1956.

[Endorsed]: Filed June 1, 1956.

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In the District Court of the United States, Western  
District of Washington, Northern Division

No. 3791

WILLIE B. BASNIGHT, Plaintiff,

vs.

ORION SHIPPING & TRADING COMPANY,  
INC., and PACIFIC CARGO CARRIERS  
CORPORATION,

Defendants and  
Third Party Plaintiffs,

vs.

UNITED STATES OF AMERICA,  
Third Party Defendant.

JUDGMENT

This Matter having come on for trial the 23rd

day of May, 1956, plaintiff Willie B. Basnight appearing in person and by his attorneys, Bassett, Geisness & Vance, J. Duane Vance of counsel; defendants Orion Shipping & Trading Company, Inc. and Pacific Cargo Carriers Corporation appearing by their attorneys, Bogle, Bogle & Gates, Robert V. Holland of counsel; third party defendant, United States of America, appearing by the United States Attorney Charles P. Moriarty, Graydon Staring and Frank Cushman of counsel; a jury having been duly impaneled and sworn; witnesses having been sworn and heard; argument of counsel having been heard; and the matter having been submitted to the jury and the jury having returned its verdict in favor of the plaintiff on the 1st day of June, 1956, which was entered on the civil docket on June 4, 1956 and on the judgment docket on June 4, 1956, and the motions of the defendants Orion Shipping & Trading Company, Inc. and Pacific Cargo Carriers Corporation for Judgment N.O.V. or for a new trial having been denied; now, therefore, in accordance therewith.

It is hereby ordered, adjudged and decreed that the plaintiff Willie B. Basnight have judgment against the defendants Orion Shipping & Trading Company, Inc., a corporation, and Pacific Cargo Carriers Corporation in the sum of \$7,900.00, effective as of June 4, 1956.

It is further ordered, adjudged and decreed that all of the foregoing shall bear interest at the legal rate from June 4, 1956.

It is further ordered, adjudged and decreed that

the plaintiff, Willie B. Basnight, have and recover his costs herein.

To all of which defendants except and their exceptions are hereby allowed.

Done in open court this 20th day of June, 1956.

/s/ JOHN C. BOWEN,

United States District Judge

Presented by and Approved:

BASSETT, GEISNESS & VANCE,  
Attorneys for Plaintiff

Approved as to form:

BOGLE, BOGLE & GATES,  
Attorneys for Defendants Orion Shipping & Trading Company, Inc. and Pacific Cargo Carriers Corporation

Copy received and notice of presentation waived:

/s/ F. N. CUSHMAN,  
Assistant United States Attorney

[Endorsed]: Filed and entered June 20, 1956.

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[Title of District Court and Cause No. 3791.]

### NOTICE OF APPEAL

Notice is hereby given that Orion Shipping & Trading Company, Inc. and Pacific Cargo Carriers Corporation, defendants above named, hereby appeal to the United States Court of Appeals for the



Ninth Circuit from the final judgment entered in this action on June 20, 1956.

BOGLE, BOGLE & GATES,  
Attorneys for Appellants, Orion Shipping & Trading Company, Inc. and Pacific Cargo Carriers Corporation.

Acknowledgment of Service Attached.

[Endorsed]: Filed July 17, 1956.

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United States District Court, Western District of  
Washington, Northern Division

No. 3792—Arthur G. B. Morriss, Plaintiff,  
No. 3791—Willie B. Basnight, Plaintiff,  
No. 3623—Charles E. Aregood, Plaintiff,  
No. 3617—Willie B. Holmes, Plaintiff,  
No. 3624—George E. Lewis, Plaintiff,  
No. 3728—Joseph E. Mitchell, Plaintiff,  
No. 3793—Ben Wilcox, Plaintiff,

vs.

Orion Shipping & Trading Company, Inc., and Pacific Cargo Carriers Corporation,  
Defendants and  
Third Party Plaintiffs,

vs.

United States of America,  
Third Party Defendant.

### ORDER OF DISMISSAL

Third party plaintiffs' complaints over against third party defendant coming on regularly for

hearing before the above-entitled court July 27, 1956, the parties being represented by counsel and further proof being offered by third party plaintiffs and the matters being fully argued and it appearing to the Court that jurisdiction of the third party actions herein is exclusively under the Suits in Admiralty Act and it further appearing that third party plaintiffs have failed to prove proper venue under the Suits in Admiral Act, now, therefore, it is hereby

Ordered that the third party complaints and amended third party complaints in each of the above-entitled actions shall be and hereby are dismissed without prejudice and without costs to either party.

Done in open court this 27th day of July, 1956.

JOHN C. BOWEN,

United States District Judge

Presented and approved by:

F. N. CUSHMAN

GRAYDON S. STARING

Attorneys for third party defendant

[Endorsed]: Filed July 27, 1956.

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[Title of District Court and Causes Nos. 3792, 3791, 3623, 3617, 3624, 3728 and 3793.]

### MOTION FOR RECONSIDERATION

Comes now the defendants Orion Shipping & Trading Co., Inc. and Pacific Cargo Carriers Corporation and moves this Honorable Court for a

reconsideration of its order and decree of dismissal in the third party action entered on July 27, 1956.

This motion is filed under Rule 59 (e) of the Federal Rules of Civil Procedure and upon the ground that proper venue and jurisdiction in the third party plaintiffs' cause of action against the third party defendant, United States of America has been properly established without allegation or proof thereof under the doctrine of ancillary venue as set forth by the Tenth Circuit in *United States v. Acord*, 209 F. (2d) 709, portions of which decision are set forth at length in the defendants' memorandum of authorities filed on April 16, 1955.

BOGLE, BOGLE & GATES,  
Attorneys for Defendants and  
Third Party Plaintiffs

Acknowledgment of Service Attached.

[Endorsed]: Filed August 3, 1956.

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[Title of District Court and Causes Nos. 3792, 3791,  
3623, 3617, 3624, 3728 and 3793.]

MOTION TO VACATE DECREE OF DISMISS-  
AL AND FOR AN ORDER TRANSFER-  
RING THE THIRD PARTY CAUSE OF  
ACTION TO THE SOUTHERN DISTRICT  
OF NEW YORK

Comes now the defendants, Orion Shipping & Trading Company, Inc. and Pacific Cargo Carriers Corporation in the above entitled causes, and moves this Honorable Court for an order vacating the

decree of dismissal entered on the 27th day of July, 1956 and transferring the third party cause of action against United States of America in each of the above entitled causes to the Southern District of New York.

This motion is made under Rule 59 (e) of the Federal Rules of Civil Procedure and upon the ground that said transfer may be made pursuant to §1406 (a) of Title 28, United States Code Annotated wherein such transfer is permitted if it is "in the interest of justice". This motion is based upon the further ground that said transfer is in the interest of justice since an attempted recovery over by the defendants against the United States of America in a new action instituted in the Southern District of New York would be time barred under the ruling of the Second Circuit in *Ryan Stevedoring v. United States of America*, (C. A. 2d, June 6, 1949) 175 F. (2d) 490, 1949 A. M. C. 1363.

BOGLE, BOGLE & GATES,  
Attorneys for Defendants and  
Third Party Plaintiffs

[Endorsed]: Filed August 3, 1956.

[Title of District Court and Causes Nos. 3623, 3617, 3624, 3728, 3791, 3792, 3793.]

ORDER DENYING THIRD PARTY PLAINTIFFS' MOTION FOR RECONSIDERATION AND DENYING THIRD PARTY PLAINTIFFS' MOTION TO VACATE DECREE OF DISMISSAL AND FOR AN ORDER TRANSFERRING THE THIRD PARTY CAUSE OF ACTION TO THE SOUTHERN DISTRICT OF NEW YORK

Third Party Plaintiffs' motion for reconsideration and motion to vacate decree of dismissal and for an order transferring the Third Party cause of action to the Southern District of New York coming on regularly for hearing before the above-entitled court August 20, 1956, the parties being represented by counsel and the matter being fully argued, it is hereby

Ordered that the said motion for reconsideration and the said motion to vacate decree of dismissal and for an order transferring the third party cause of action to the Southern District of New York shall be and hereby are denied.

Done in open court this 20th day of August, 1956.

JOHN C. BOWEN,

United States District Judge

Presented and approved by:

GRAYDON S. STARING,

Attorney for Third Party Defendant



Approved as to form:

BOGLE, BOGLE & GATES,

ROBERT V. HOLLAND,

Attorneys for Third Party Plaintiffs

[Endorsed]: Filed August 20, 1956.

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[Title of District Court and Cause No. 3791.]

### NOTICE OF APPEAL

Notice is hereby given that Orion Shipping & Trading Company and Pacific Cargo Carriers Corporation, defendants above named, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the final judgment in the third party action against the United States of America entered on July 27, 1956.

The defendants also appeal from the Order Denying Third Party Plaintiffs' Motion for Reconsideration and Denying Third Party Plaintiffs' Motion to Vacate Decree of Dismissal and for an Order Transferring the Third Party Cause of Action to the Southern District of New York, entered on August 20, 1956.

BOGLE, BOGLE & GATES,

Attorneys for Defendants and

Third Party Plaintiffs

[Endorsed]: Filed September 7, 1956.

[Title of District Court and Cause No. 3791.]

### AMENDED COST BOND ON APPEAL

That we, Orion Shipping & Trading Company, Inc., and Pacific Cargo Carriers Corporation as principal, and National Surety Corporation, as surety, are held and firmly bound unto Willie B. Basnight and United States of America in the full and just sum of Two Hundred Fifty (\$250.00) Dollars, to be paid to the said Willie B. Basnight, his successors, executors, administrators, and assigns, and to the United States of America; to which payment, well and truly to be made, we bind ourselves, our successors, assigns, heirs, executors, and administrators, jointly and severally by these presents.

Sealed with our seals and dated this 5th day of September, 1956.

Whereas, on June 8, 1956, in an action pending in the United States District Court for the Western District of Washington, Northern Division, between Willie B. Basnight as plaintiff and Orion Shipping & Trading Company, Inc. and Pacific Cargo Carriers Corporation as defendants, a judgment was rendered against the said defendants and the said defendants having filed a notice of appeal from such judgment to the United States Court of Appeals for the Ninth Circuit; and

Whereas, on July 27, 1956 in the third party action with Orion Shipping & Trading Company and Pacific Cargo Carriers Corporation as third party plaintiffs and the United States of America as third

party defendants, a judgment was rendered for United States of America, third party defendant, and against Orion Shipping & Trading Company, Inc. and Pacific Cargo Carriers Corporation, third party plaintiffs and the said third party plaintiffs having filed a notice of appeal from said judgment to the United States Court of Appeals for the Ninth Circuit;

Now, therefore, the condition of this obligation is such, that if the said defendants and third party plaintiffs shall prosecute their appeals to effect and shall pay costs if the appeals are dismissed or the judgments affirmed, or such costs as the said Court of Appeals may award against the said defendants if the judgments are modified, then this obligation to be void; otherwise to remain in full force and effect.

ORION SHIPPING & TRADING  
COMPANY, INC., and PACIFIC  
CARGO CARRIERS CORPORA-  
TION,

By BOGLE, BOGLE & GATES,  
Their Attorneys,  
Principals

NATIONAL SURETY CORPORA-  
TION,

[Seal]     /s/ By (Illegible),  
Attorney-in-Fact,  
Surety

[Endorsed]: Filed September 7, 1956.

[Title of District Court and Cause No. 3791.]

DOCKET ENTRIES

\* \* \* \* \*

1956

Apr. 20—Filed third party defendant's request for admissions. (30)

Apr. 23—Ent. order continuing all motions to 4-30-56 at 10 a.m.

Apr. 30—Ent. order denying deft's motion to produce, counsel having made an arrangement.

\* \* \* \* \*

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[Title of District Court and Cause No. 3623.]

DOCKET ENTRIES

\* \* \* \* \*

1954

Dec. 6—Ent. record of hearing on motion to dismiss third party complaint. Granted.

Dec. 29—Filed Motion to Transfer cause to Calendar of Judge John C. Bowen. (22)

” —Filed Petition to vacate order granting Third Party Deft.'s Motion to Dismiss Third Party Complaint. (23)

” —Filed Note for hearing above motion on January 3, 1955. (24)

Dec. 30—Filed Notice for hearing Motion to Transfer cause to Judge Bowen, on January 3, 1954. (25)

1955

Jan. 3—Motion to transfer cause to Judge Bowen called and granted subject to his approval.

1955

- Jan. 3—Petition of deflt. and third party plttf. to vacate order granting motion to dismiss third party complaint called and granted.
- ” —Filed Amended Order of defendant’s motion to elect. (26)
- ” —Judge Bowen accepts transfer of this case.
- Jan. 7—Filed Order vacating previous order granting motion to dismiss third party complaint.
- ” —Filed Order transferring cause to Judge Bowen.
- Jan. 12—Filed Answer of deflt. and third party plttf.
- Jan. 21—Filed Second Amended Complaint and demand for jury.
- Jan. 25—Filed Stipulation re second amended complaint.

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[Title of District Court and Cause No. 3791.]

**CERTIFICATE OF CLERK U. S. DISTRICT  
COURT TO RECORD ON APPEAL**

United States of America,  
Western District of Washington—ss.

I, Millard P. Thomas, Clerk of the United States District Court for the Western District of Washington, do hereby certify that pursuant to the provisions of Subdivision 1 of Rule 10 of the United



States Court of Appeals for the Ninth Circuit and Rule 75 (o) of the Federal Rules of Civil Procedure, I am transmitting herewith, the following original papers in the file dealing with the action, as the record on appeal herein to the United States Court of Appeals at San Francisco, to-wit:

1. Complaint, filed September 20, 1954.
2. Marshal's return on summons, filed September 20, 1954.
3. Interrogatories Addressed to Plaintiff by the Defendants, filed September 20, 1954.
4. Notice of Defendants to take deposition of Plaintiff, filed September 20, 1954. .
5. Appearance of Krusen, Evans and Shaw as attorneys for Defendants, filed September 20, 1954.
6. Motion of Defendants to Transfer, filed September 20, 1954.
7. Order Granting Defendants' Motion to Transfer, filed September 20, 1954.
8. Appearance of Bassett, Geisness and Vance as attorneys for Plaintiff, filed October 14, 1954.
9. Motion of Defendants to Elect, filed January 13, 1955.
10. Appearance of Bogle, Bogle and Gates as attorneys for Defendants, filed January 13, 1955.
11. Motion of Defendants to Bring in Third Party Defendant and Order granting same, filed April 11, 1955.
12. Notice of Defendants and Third Party Plaintiffs to hear Motion to Bring in Third Party Defendant, filed April 6, 1955.
13. Third Party Complaint, filed April 11, 1955.

14. Praecipe, summons to Third Party Defendant U. S., filed April 12, 1955.

15. Marshal's return on summons, Third Party Defendant U. S., filed April 15, 1955.

16. Motion of Third Party Defendant U. S. to Dismiss Third Party Complaint, filed June 15, 1955.

17. Memorandum of Third Party Defendant of Points and Authorities in Support of Motion to Dismiss Third Party Complaint, filed June 15, 1955.

18. Affidavit of Keith R. Ferguson, filed June 15, 1955.

19. Motion of Defendants and Third Party Plaintiff to Consolidate, filed September 14, 1955.

20. Notice of Defendants and Third Party Plaintiffs to hear Motion to Elect and Motion to Consolidate, filed September 14, 1955.

21. Order Granting Defendants' Motion to Elect, filed October 6, 1955.

22. Answer of Third Party Defendant to Third Party Complaint, filed October 7, 1955.

23. Stipulation and Order Re Motion to Consolidate, filed April 9, 1956.

24. Interrogatories Propounded to Third Party Defendant by Defendant and Third Party Plaintiff, filed April 11, 1956.

25. Motion of Defendant and Third Party Plaintiff, Orion Shipping and Trading Company to Produce, filed April 11, 1956.

26. Motion of Defendant and Third Party Plaintiff Orion Shipping and Trading Company to Sever Third Party Claim, filed April 11, 1956.

27. Notice of Defendants and Third Party Plain-

tiffs to hear Motion to Produce and Motion to Sever Third Party Claim, filed April 11, 1956.

28. Notice of Defendants and Third Party Plaintiffs to take depositions of Willie B. Basnight and Arthur G. B. Morriss, filed April 12, 1956.

29. Answer of Defendants, filed April 13, 1956.

30. Request of Third Party Defendant for Admission of Facts and Genuineness of Documents, filed April 20, 1956.

31. Deposition of Dr. Gordon L. Maurice, filed May 7, 1956.

32. Deposition of Willie B. Basnight, filed May 16, 1956.

33. Order Granting Defendants and Third Party Plaintiffs' Motion to Sever, filed May 22, 1956.

34. Trial Memorandum of Plaintiffs, filed May 23, 1956.

35. Verdict for Plaintiff, filed June 1, 1956.

36. Order Denying Motion of Defendants for Judgment N.O.V., or in the Alternative for a New Trial, filed June 18, 1956.

37. Statement of Costs and Disbursements to be Taxed Against Defendants, filed June 20, 1956.

38. Judgment, filed June 20, 1956.

39. Notice of Appeal by Defendants, filed July 17, 1956.

40. Cost Bond on Appeal, filed July 17, 1956.

41. Copy of Order of Dismissal of Third Party Complaint, filed July 27, 1956.

42. Order (Copy) Denying Third Party Plaintiffs' Motion for Reconsideration, etc., filed August 20, 1956.

I further certify that the following is a true and correct statement of all expenses, costs, fees and charges incurred by my office by or on behalf of the appellant for preparation of the record on appeal in this cause, to-wit: Filing fee, Notice of Appeal, \$5.00; and that said amount has been paid to me by the attorneys for the appellant.

Witness my hand and official seal at Seattle this 21st day of August, 1956.

[Seal]      MILLARD P. THOMAS,

Clerk

/s/ By TRUMAN EGGER,

Chief Deputy

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[Title of District Court and Causes Nos. 3623, 3792, 3791, 3617, 3624, 3728, 3793.]

## TRANSCRIPT OF PROCEEDINGS

Be it remembered, that the above entitled and numbered causes were consolidated for trial and heard before the Honorable John C. Bowen, one of the Judges of the above entitled Court, and a jury, beginning Wednesday, May 23, 1956, at 10:00 o'clock a.m. [1]\*

Plaintiffs Aregood and Mitchell were represented by Mr. Edwin J. Friedman, of Messrs. Levinson & Friedman, Attorneys at Law.

Plaintiffs Morriss, Basnight and Wilcox were represented by Mr. J. Duane Vance, of Messrs. Bassett, Geisness & Vance, Attorneys at Law.

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\* Page numbers appearing at foot of page of original Reporter's Transcript of Record.



Plaintiffs Holmes and Lewis were represented by Mr. John D. Spellman, of Messrs. Kane & Spellman, Attorneys at Law.

Defendants and Third Party Plaintiffs were represented by Mr. Robert V. Holland, of Messrs. Bogle, Bogle & Gates, Attorneys at Law.

The Third Party Defendant was represented by Mr. Graydon S. Staring, Attorney, Department of Justice, and Mr. Francis N. Cushman, Assistant United States Attorney.

Whereupon, the following proceedings herein were had and done, to-wit:

The Court: In the following cases, Cause No. 3623, entitled Charles E. Aregood vs. Orion Shipping and Trading Co., defendant, and later named as third party plaintiff in a proceeding over against the United States as a third party defendant; also [2] Cause No. 3728, entitled Joseph E. Mitchell vs. Orion Shipping and Trading Co., defendant and third party plaintiff, and against the United States of America as third party defendant; also Cause No. 3617, entitled Willie B. Holmes vs. Orion Shipping and Trading Company, defendant and third party plaintiff, against the United States of America as a third party defendant; also Cause No. 3624, entitled George E. Lewis vs. Orion Shipping and Trading Company, defendant and third party plaintiff, against the United States of America as a third party defendant; also Cause No. 3791, entitled Willie B. Basnight vs. Orion Shipping and Trading Company, defendant and third party plaintiff, against the United States of America as third party



defendant; also Cause No. 3792, entitled Arthur G. B. Morriss vs. Orion Shipping and Trading Company, defendant and third party plaintiff, against the United States of America as third party defendant, and also Cause No. 3793, entitled Ben Wilcox vs. Orion Shipping and Trading Company, defendant and third party plaintiff, against the United States of America as a third party defendant, all of which cases just identified by the Court have been and are now consolidated for trial, are the parties and Counsel ready to proceed with the trial of each and all of those consolidated [3] actions just identified by the Court?

Mr. Vance: We are, your Honor.

The Court: Are the plaintiffs all ready?

Mr. Friedman: Yes, your Honor.

Mr. Spellman: Yes, your Honor.

Mr. Vance: We are, your Honor.

The Court: Are the defendants all ready?

Mr. Holland: Yes, your Honor.

Mr. Staring: If your Honor please, the United States, as your Honor knows, reserves the objections as heretofore made to this trial on the grounds of jurisdiction and otherwise. For that reason I cannot say that the government is ready to try the case in the sense that it would be if we did not make those objections. The government is present and will remain present to protect its record in the event of an adverse ruling.

The Court: The Court overrules the objection stated by Counsel for the United States of America. The Court states, and I ask Counsel to make a cor-

rective statement if the Court's statement now about to be made is incorrect, the trial of these actions before the jury asked to be in attendance today and some of whom will be empaneled as the jury to try these consolidated cases are for trial as between the plaintiff and the defendant, [4] namely, the plaintiff in each case, the first one named being the Aregood case against Orion Shipping and Trading Company, defendant. So far as the United States of America is concerned, there is no trial before this jury. The evidence will be received and will be considered by the Court as the fact trier later so far as the United States of America is concerned in a final trial proceeding and not before a jury, this jury or any other.

Mr. Vance: If your Honor please, I would like to call your attention to the fact that in the three cases in which I appear, 3791, 3792 and 3793, the Pacific Cargo Carriers Corporation is likewise a defendant.

The Court: Then let the record show that correction. I wish to know if Counsel know of any inaccuracy in the Court's statement about the United States of America not being on trial before this jury to be empaneled here today. Does any plaintiff ask the jury to be empaneled to try these consolidated cases to make any finding for or against the United States of America?

Mr. Vance: No, your Honor.

Mr. Friedman: No, your Honor. However, I think the jury should be advised—— [5]

The Court: In so far as there may be any lia-

bility over in respect to the third party action against the United States of America, that is a matter which may depend in part upon the outcome of this action before this jury to be empaneled here today.

Mr. Friedman: That is correct, your Honor.

The Court: But as to what it is or as to whether there is such liability against the United States and, if so, how much, is not before and will not be before this jury to be empaneled here today to try these cases. Is that correct?

Mr. Friedman: That is correct, and I think further the jury should be advised that the Court during the course of this trial is considering the liability of the United States of America so that they should know.

The Court: All of the jurors and all parties to this action are so advised, that the Court is the fact trier so far as the actions over against the third party defendant United States of America is concerned, the Court is the trier of the fact and will be trying the case against the United States of America only in so far as the evidence concerns the issues between any and all other parties and the United States of America. This jury will not be required to pass upon any question that [6] concerns the United States of America in respect to granting any relief at the hands of this jury against the United States of America.

Mr. Staring: If your Honor please, there is one matter which is related to your Honor's statement which I would like to clear up. The government

considers that it has as against the plaintiffs in their case being presented to this jury all objections to evidence which defendant Orion Shipping and Trading Company would have.

The Court: Let the record show Counsel's statement, and the objection is overruled. Is there any other statement so far as identification of these cases to be tried before this jury and in so far as the issues are concerned and in so far as the identity of the parties litigant is concerned?

Mr. Friedman: If the Court please, I am not quite clear on the ruling of the Court. My understanding is that by order of the Court the action over has been severed from the principal action.

The Court: It is true, but severed in the sense of the fact trier's determination.

Mr. Friedman: Yes.

The Court: In so far as the evidence to be received before this jury may throw any light upon [7] the issues in the third party action to recover over against the United States, this presiding trial judge is at any and all times acting as the trier of the fact.

Mr. Friedman: I understand.

The Court: And the jury is not acting as the trier of the fact.

Mr. Friedman: Is Mr. Staring entitled to cross examine the plaintiffs in their case in chief against Orion? That's what I'm not quite clear on.

The Court: He certainly is. Is there anything else to be noted? I will ask at the proper time that Counsel for the plaintiffs make a very brief state-



ment of the nature of each case so far as the issues as between the parties are concerned and as those issues are disclosed by the pleadings, and to state the identity of the parties, Counsel and witnesses who are expected to be connected with this trial, with a view to trying thereby to assist the prospective jurors in manifesting their qualifications to act as trial jurors in these particular consolidated cases.

I now ask the clerk to call a jury to try these consolidated cases.

\* \* \* \* \*

The Court: Is there anything to be done in the absence of the jury?

Mr. Staring: If your Honor please, I thought it might save the Court and Counsel a little time if the Court would make an order that the government's continuing objection to all testimony and evidence in this case be deemed to run to any testimony or evidence offered on the grounds of incompetency, irrelevancy and immateriality to any issue as between Orion and the government in this case, and upon the further ground that we object to its being taken before the jury or in a case in which a jury is empaneled, and if that objection could be deemed by your Honor to run throughout the case it would be unnecessary for me to go ahead and take up the Court's time and Counsel's time.

The Court: Do Counsel object to the Court's granting the request stated by Counsel for the United States?



Mr. Friedman: No objection, your Honor.

Mr. Vance: No objection, your Honor. [12]

Mr. Spellman: No objection, your Honor.

Mr. Holland: No objection, your Honor.

The Court: The Court is agreeable to having that understanding; that is, that the objection continue throughout the trial so long as this jury is functioning.

Mr. Staring: Thank you, your Honor.

The Court: And the Court overrules the objection as of this time and as of all other times material to the preservation of the objection by government Counsel. Bring in the jury. The Court prefers, of course, to hear the opening statements of plaintiffs' Counsel and defendants' Counsel may at that time or at some proper later stage of the trial make the defendants' opening statement. [13]

\* \* \* \* \*

(The following proceedings were had without the presence of the jury:)

The Court: I believe now we can hear you.

Mr. Staring: If your Honor please.

The Court: Mr. Staring. [113]

Mr. Staring: The evidence will show that on August 17, 1953, the SS Sea Coronet was a privately owned and privately operated cargo vessel; that on that date she was present at Quay 2, a regular pier or wharf in the Port of Pusan and within the territorial limits and within the jurisdiction of the Republic of Korea, a foreign country. The evidence will show that at that time and place she was receiving a quantity of material

owned and possessed by the United States which was billed and signed as scrap material consigned to Yokohama, Japan, and which was being loaded aboard the Sea Coronet by Korea Heavy Lift Corporation, an independent contractor. The evidence will show that in that scrap were a number of chlorine flasks marked Empty and considered to be as marked by everyone present and concerned, whether on the quay or on the ship.

The evidence will show that one of those flasks in fact contained some chlorine, and that while it was being loaded aboard the ship the valve or some part of it broke and chlorine escaped. I believe the evidence will fail to disclose any agent or employee of the United States of America who was present at that time and place having knowledge of the risk of the presence of that chlorine gas or [114] any reason to inquire about the possibility of that risk. The evidence will fail to disclose any United States agent or employee present who failed to take any and all appropriate safety measures required by the nature of the scrap cargo that was believed by all present to be in the course of being loaded.

The evidence will show that all the flasks, all the chlorine flasks in that scrap material were carried by the Sea Coronet to Yokohama, Japan, and were discharged there and are not now within this district.

The evidence will show that all the acts complained of, whether they occurred on the shore, on the quay, or elsewhere ashore or on board the Sea

Coronet, occurred in a foreign country, namely Korea.

Finally the evidence will show that Orion Shipping and Trading Company, the defendant and third party plaintiff here, is a New York corporation and a resident of New York, not a resident of the Western District of Washington.

Based upon those facts we believe that your Honor should deny jurisdiction over the United States in this case. [115]

[Endorsed]: Filed August 28, 1956.

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[Title of District Court and Causes Nos. 3623, 3792, 3791, 3617, 3624, 3728, 3793.]

## COMPLAINTS OVER PROCEEDINGS

Be it remembered that the mater of the complaints over proceedings in the above entitled and numbered causes was heard before the Honorable John C. Bowen, one of the Judges of the above entitled Court, beginning Friday, July 27, 1956, at 10:00 o'clock a.m.

The defendants and third party plaintiffs were [1] represented by Mr. Robert V. Holland, of Messrs. Bogle, Bogle & Gates, Attorneys at Law.

The third party defendant was represented by Mr. Graydon S. Staring, Attorney, Department of Justice, and Mr. Francis N. Cushman, Assistant United States Attorney.

Whereupon, the following proceedings herein were had and done, to-wit: [2]

Friday, July 27, 1956, 10:00 o'clock a.m.

(All parties present as before, except plaintiffs and their Counsel.)

The Court: In the cases of the so-called Orion Shipping and Trading Company group, one of them is the Aregood case, and there are others, are the parties, Counsel and witnesses ready to proceed with that part of that case which concerns the action over against the United States of America?

Mr. Holland: Yes, your Honor.

Mr. Staring: Subject to all objections already made the United States is, your Honor.

The Court: That is true, is it, with respect to all of those cases which were consolidated for trial before a jury recently and which resulted in verdicts for the plaintiffs against the named respondents in those jury trials?

Mr. Holland: Yes, your Honor.

Mr. Staring: Yes, your Honor.

The Court: What is the lowest number?

The Clerk: 3617, your Honor, but the record was filed in 3623.

The Court: The cases being numbered 3617, [3] the Holmes case; 3623, the Aregood case; 3624, the Lewis case; 3728, the Mitchell case; 3791, the Basnight case; 3792, the Morriss case, and 3792, the Wilcox case. The respondents Orion Shipping and Trading Company, a corporation, and others, respondents, being in this action before the Court today cross-plaintiffs, I guess you would call them——

Mr. Holland: Third party plaintiffs, your Honor.



The Court: All right, cross party or third party plaintiffs, may now make their opening statement of what they think the proof will be in this action, or such third party plaintiffs may otherwise proceed at this time.

Mr. Holland: If the Court please.

The Court: Mr. Holland.

Mr. Holland: Preliminarily it was the understanding of the respondents at the time this matter was continued at the termination of the principal cases that the argument with the government would be towards the middle or the latter part of August, in my recollection. At the time of being advised by the Court on Monday of this week or Tuesday of this week that the matter would be heard today, I had already prepared but had not yet served and filed a request [4] for admissions upon the government. I filed the requests on that very day. Mr. Staring states that he does not object to the shortness of time for answering the request for admissions but states that he cannot admit to all of the facts therein contained, and to the extent that objection is made by the government to the facts contained in the request for admissions the respondents would request the Court for either a continuance or additional time at a later date to prove those facts which the government Counsel cannot agree to.

The Court: The only thing, Mr. Holland, is that if the Court is convinced that there is real prejudice, and it would be difficult for me to do so because my understanding of the trial date was sub-



ject to this condition, that if the Court's Bellingham or other calendar affairs made it possible, it was subject to the Court's calling the matter up for this further proceeding as soon as it was convenient to the Court, and if there is any real prejudice about the matter I will hear it. I do not want any more piecemeal trials on anything. I want to clean up instead of dismembering and delaying in part any litigation. I want to get the thing cleaned up. What is the prejudice?

Mr. Holland: Well, perhaps, your Honor, [5] this argument will bring out what prejudice if any exists. Actually none may exist, and if it does not we need not consider the matter further. May I renew my motion in that event then?

The Court: Yes, you may move at any time for anything and the Court will consider it, Mr. Holland.

Mr. Holland: Secondly, if the Court please, Mr. Staring, the government Counsel, has stipulated with me to the fact that the SS Sea Coronet at some time following this occurrence was purchased by another company, Alaska Steamship Company; that it was renamed the Tonsina, and that the Tonsina has been in and out of this port during the pendency of this action.

Mr. Staring: If your Honor please, that is subject, however, to an objection on the grounds of its being irrelevant and immaterial. I contend that it does not matter whether the ex SS Sea Coronet has been in and out of this port during the pendency of this litigation.

The Court: Do you wish the record to show that as to every request for admission not yet disposed of or in some manner regarded by Counsel as being determined, that if the government makes a response to the request for admission it is without prejudice to the continuing objection of the [6] government that the request is immaterial and the answer is immaterial?

Mr. Staring: I would appreciate that, your Honor.

The Court: Have you any objection to that? The Court can always determine that.

Mr. Holland: No objection, your Honor.

The Court: That request for continuing objection is approved by the Court.

Mr. Staring: Might I suggest, however, that with respect to Mr. Holland's request for admission, the government has objections more specific than those general ones which are already made of record, and if the Court should not agree with us upon those objections the government stands ready, notwithstanding the shortness of time, to make its answer at this time, but——

The Court: How long would it take for you to present and to submit to the Court these objections?

Mr. Staring: I don't think it will take me more than three minutes, your Honor.

The Court: Very well. As I understand it, Mr. Holland for the third party plaintiffs has already made the requests effectively upon the United States, third party respondent, and the question

now is whether or not the third party respondent will be required to respond to those requests. Is that right? [7]

Mr. Staring: That is correct, your Honor.

The Court: What would be the order? Do you think that Mr.—

Mr. Staring: Since Mr. Holland relies upon this for part of his proof it seems to me we should argue it now and have it decided.

The Court: I wish to hear it.

Mr. Staring: If your Honor please, Orion has served on the government on July 24th a request for admission requesting the government to admit first the genuineness of a photostatic copy of a time charter party executed by Pacific Cargo Carriers Corporation and the United States of America dated July 3, 1952, a copy of which is attached to the request. Orion also asks the government to admit that the charter party was in effect at the time of the Korean incident and makes two further requests for admission as to relationships between Orion Shipping and Trading Company and Pacific Cargo Carriers Corporation. All these requests seem to center on the charter party.

Now, if your Honor please, these cases were brought in tort, and your Honor could look at the third party complaints in vain to find any suggestion of a breach of contract, any pleading of breach of contract. By this point in the case I think we [8] are entitled to know on what theory this case proceeds and under what jurisdiction it is claimed to proceed. There is no mention of any contract.

The matter is entirely one of tort. The elements would be different.

The Supreme Court has held in *Matson Navigation Company vs. United States*, 284 U. S. 352, that an action on a time charter party, such as this one is, must be prosecuted exclusively in admiralty under the Suits in Admiralty Act against the United States.

On these grounds, your Honor, we contend that the requests for admission of the facts and documents sought to be admitted are wholly irrelevant and immaterial to any issue presented by the pleadings in these cases.

The Court: I will hear your response as to materiality.

Mr. Holland: If the Court please, the third party complaint is drawn on the theory of tort and of negligence of the United States Army. The time charter party in its provisions concerning the respective duties and rights and liabilities of the two parties in the operation of the vessel in which the government was the time charterer would point out without the necessity of alleging a breach of said contract, would point out to the Court the duties of the government with respect to what [9] they did aboard the vessel and would be material in indicating whether or not they had failed to do that which not only was reasonable and proper under the general law of tort, but that which was set forth and embodied in the time charter party. We think for that reason it is relevant and should be placed in evidence.



The Court: Do you contend two things, one, that you base the right under the contract relationship spoken of in the Ryan decision that rises over and above the contract obligation?

Mr. Holland: Our ground of recovery is principally on the theory of what was in the Rryan decision which was outside an express contract.

The Court: And do you assert the right to have the remedy of relief for that right and the failure of the United States to recognize it under the Suits in Admiralty Act, or under what Act?

Mr. Holland: Under the Suits in Admiralty Act and the Federal Torts Act, if the Court pleases. We have alleged both Acts.

The Court: Is there jurisdiction under both Acts in this case against the United States?

Mr. Holland: We believe there is, your Honor, yes. [10]

Mr. Staring: If your Honor please, since the Ryan case has been mentioned I should like to mention what I deem an error about it. The Ryan case turns upon a term of a contract. The Ryan case is a case of breach of contract and interpretation of that contract.

The Court: I got the impression, and it is what I remember of the impression, I haven't read the Ryan case since this Aregood case—I have forgotten when the last time I read the Rryan case was. It was fairly recently but it has not been within the last three weeks, so I am depending upon my impression, and it is at least three weeks old, the last one I got. I got the impression as it lingers



in my mind now the last time I read the Ryan case, which was not less than three weeks ago, that it recognized this right of recovery over for some kind of an indemnity no matter whether the contract between the parties expressly preserved the right or whether or not it had some obligation which the law creates wholly independent of an outside contract.

Mr. Staring: If your Honor please, the Court I believe tried to make it clear that they were not because they had to avoid that not to come in conflict with the Longshoremen's Act, they had to avoid [11] any duty by implication of law.

The Court: All right.

Mr. Staring: They said the duty is a warranty—when you make a contract to load you mean you will load safely and properly. That is what the contract means.

The Court: I stand corrected, but I do think that the Court reserved the right to more explicitly rule upon the question as to whether the Court was left to determine whether the right was raised by operation of law and existed notwithstanding the Longshoremen's Act. They were leaving that for the future. Whatever they wished to do. It seems to me in regard to that the Court wanted to give consideration when the negligence which was the basis of the cause of action in the main suit was, so far as the relationship between the third party plaintiff and the third party respondent were concerned, the less active and not momentarily concurrent, but there was a right over,

and the Court is unable to sustain the objection made to the right to proceed here in this case and therefore overrules the objection of the government thus stated.

Mr. Staring: At this time, your Honor, I will make a service—— [12]

The Court: Of course there is no need of our taking up anyone's time to express surprise at a great legal tribunal of the world taking a view like this. It is the most extraordinary thing I ever heard of as a lawyer, but we have this decision and, like all other decisions, whether it is a rational one or a sound one or whether it seems to be from anybody's point of view on a very unsound basis, we have to accept it and have to try to interpret it. Needless to say, if I had had anything to do with making the law I would not think of a rule like this. I think it is the most troublemaking kind of a judicial legislation that I ever knew of, but we have it, and the Supreme Court has been admitted in recent times to have the authority to make such rules, and you and I have no way of changing them. And so I believe the Supreme Court indicated that it intended that this Court in this particular case and all others like it should apply that rule here, Mr. Staring, and I am going to do it as long as I can tell that it is a situation where I think reasonably that the Court intended that the principle of that Ryan decision should apply.

Mr. Staring: At this time I have served Mr.

Holland and will offer for filing the government's answers to the requests for admissions. [13]

The Court: I will try to apply that principle or policy which I last announced just as carefully and earnestly and unfailingly as if I myself was the one that first thought of this rule announced in the Ryan case and felt it was the wisest and most just and best authorized and the most documented as to previous authority in the world, as long as I am performing the duties of this court.

Mr. Staring: With respect to Mr. Holland's proposed stipulation as to the Sea Coronet's entering this district during the pendency of this suit, I want to make sure that I have effectively objected that the presence of the Sea Coronet here in this district, which I understand Mr. Holland wants to establish for purposes of showing compliance with the Suits in Admiralty Act, is irrelevant and immaterial under that Act since in this case there is no attempt to charge a government vessel. The Sea Coronet is not a government vessel. There is no attempt to charge it with liability, so its presence here is immaterial. The presence of the cargo sought to be charged is material. The presence of the suitor itself, the presence of Orion, is material, but subject to that objection I will certainly agree that the vessel has entered the district within the pendency of the suit and not at any [14] specified dates which I don't know.

The Court: Of course, Mr. Staring, if one had the duty to prove that the cargo was present, one of the best ways in the world to prove that the

cargo was present in the district is to prove the presence of the vessel on which it was.

Mr. Staring: Your Honor, the presence of the cargo has already been proved in the case by admissions of Orion. The cargo was discharged in Japan and has never been in this district, and that is admitted. We are speaking of the cargo and not some subsequent cargo which the ship might have carried.

The Court: What is it you are admitting, then, that is material here?

Mr. Staring: I don't believe that any of it is material. Mr. Holland wants it in the record and I am willing to admit that it is a fact, but I object that it is utterly irrelevant and immaterial.

The Court: Mr. Holland, what is it that makes it material? You are not suing the vessel or you do not claim that the vessel was the thing which was the basis for the provisions of the Suits in Admiralty Act for providing jurisdiction in personam against the United States. What is it which you seek?

Mr. Holland: Well, if the Court pleases, [15] our claim of liability against the government is based both against its vessel, referring to the fact that the government time chartered the vessel, and also the cargo. The fact that this was not a government vessel or a government owned vessel is immaterial, at least under some cases on the point, for example 65 Federal Supplement 191, where the Court said that the United States would be liable for a personal injury or illness to the seaman where



the vessel was only time chartered by the United States, and we feel that——

The Court: Where it was under operative control of the United States?

Mr. Holland: No, your Honor, it was time chartered by the United States. It was operated by another agency.

The Court: By “time charter”, do you contend that even though one is not the owner it is the time charterer owning the right to dispose of the vessel under a time charter party’s terms which in some respects make it for the time being the owner of the vessel and the user of the vessel in the way that it sees fit to use it, is that what you contend, that that is all that is necessary?

Mr. Holland: That is correct, your Honor.

The Court: Mr. Staring, will you answer that point? [14]

Mr. Staring: If your Honor please, I think that to answer this it is only necessary to look at the scheme of the Suits in Admiralty Act. The Suits in Admiralty Act is to provide a remedy against the United States for damages—I’m speaking of damages caused by its vessels and its cargo.

The Court: As offending things?

Mr. Staring: As offending things. Now, I don’t mean by that to imply that it is limited to in rem rights. It has been held by the Supreme Court that it is not. But when the Suits in Admiralty Act contemplating suits against the United States provided that such suits shall be brought in the district where the parties so suing or any of them



reside or have their principal place of business, or in which the vessel or cargo charged with liability is found, they don't mean the vessel charged with liability by somebody else, they mean the vessel which forms the basis of the charge of liability against the United States.

Now, in this case plainly the emphasis is on cargo. The thing which is charged with liability in this case in the sense of this lawsuit is the cargo, not the vessel at all, and it's the location of the cargo that counts. It doesn't make any sense in [17] view of the purpose of this statute to decide that Orion is operating the vessel for the purpose of being sued by these libelants but then in some mysterious way Orion can sue the United States because at Orion's wish the United States is now operating the vessel. It's the cargo Orion is trying to charge with liability.

The Court: Hasn't the cause of action which has been asserted against the respondents in the jury tried cases turned out to be the very same cause of action, the very same wrong that was done by these persons who were sued as respondents in the law action before the jury which is asserted now, according to your theory, against the cargo? Is it in truth and fact the very same affirmative act, whether it be regarded as having been done by somebody in person or by the offending thing?

Mr. Staring: No, your Honor, I believe it is not. In the jury actions what was established was either that the SS Sea Coronet was unseaworthy or that Orion and Pacific Cargo Carriers were

negligent, or both, with respect to matters on which testimony was given, your Honor, occurring on board that ship.

Now, there was no testimony in the case, there has been none showing how that cargo got aboard the ship in the condition in which it was, what [18] might have occurred on shore, who might have done it, or where.

As I understand it, the claim that Orion makes against the United States is based upon the bringing of that cargo on board or collateral matters such as failure to give warning or post guards or matters of that sort, but it is a charge of negligence and fault in officers and employees of the government. Orion has not been held liable in this case at all for any negligence or fault of officers or employees of the government. Orion has been held liable by this jury for negligence or fault of its own employees.

The Court: Under the charter party it owed a duty, and if that duty has not been performed would not the United States be then subject to being sued under this Ryan Act case, and if the cargo in question had been in the jurisdiction of this Court would not the United States then be suable here as a place of proper venue?

Mr. Staring: Well, let me say, I don't want to go into the Ryan case again, your Honor, I think that in some circumstances the United States would have been suable without the Ryan case. I don't think, in short, that the Ryan case has changed a single thing about this suit. There was a time [19]

charter, it is admitted now, there was a time charter relationship between the United States and Orion. It could have been contended by Orion, and I think maybe this is the time to say very candidly, your Honor, that the United States throughout this suit has not contended that Orion was without any remedy against the United States; that if the United States had been in fault the United States was entitled to prevail nevertheless simply because no remedy was provided. A remedy is provided. The relations of these parties with respect to cargo are governed by a charter party, just as in the Ryan case a contract was in the case and it was a question of interpreting it.

Now, there is a charter party here, and the Supreme Court says that in such a case where the relations of the parties are governed by a charter party you may only sue in admiralty pursuant to the Suits in Admiralty Act. Orion therefore could have brought its suit and has its remedy, very frankly, in the Southern or Eastern District of New York by a single suit in admiralty alleging the existence of all these suits and the possible further damages from similar suits. The remedy is provided, but this is not it, and every effort is being made here to strain this into the remedy [20] provided. It is not. The exclusive remedy is in admiralty under the Suits in Admiralty Act back in New York where Orion resides.

Now, if the cargo, that chlorine flask which offended, had been here in the Western District of Washington, yes, I agree, Orion could then have

filed a suit in admiralty against the United States in this District, but that wasn't the case. The cargo was never here and Orion never resided here. This was not the place, and furthermore they haven't even tried to bring a suit in admiralty. This is not a suit in admiralty.

The Court: Mr. Holland, did you wish the record to show your final statement?

Mr. Holland: Yes, your Honor. Going back to our original problem, which was whether or not we are suing the cargo or are suing the vessel, the allegations of the third party plaintiff against the government claimed negligence and carelessness in loading aboard the vessel a cylinder full of chlorine gas and treating it as a part of the scrap aboard the vessel and failing to take the proper precautions to prevent the escape of the chlorine gas, also in failing to maintain a proper security watch, to give appropriate warning of the escape of the gas.

Now, all of those alleged acts of negligence [21] cannot be said to force us to go only after the specific piece of cargo which is the offending object. It's no different than if a part of the government-loaded cargo had fallen on somebody through negligence of one of their other men; we do not have to go after the cargo. We can go after the government under the Suits in Admiralty Act, the vessel or its cargo, and since under the *Penario* case even though the vessel is time chartered by the United States Government and has, as your Honor phrased it, temporary control over the vessel as far as where it goes and what is loaded in



it, the mere fact the government is only a time charterer of the vessel does not mean that the government cannot be sued under the Suits in Admiralty Act in an attempt to fasten liability upon the vessel, because they were for that purpose in charge of the vessel, they did acts aboard which were negligent, and we may sue the vessel under Suits in Admiralty because of that negligence. Likewise we may also name the cargo.

The Suits in Admiralty Act is alternative. The vessel or its cargo are exempt from attachment, which is the purpose of the Act, and as a counter remedy for the injured plaintiff they may file this libel in personam, and it is not necessary that we [22] prove that both vessel and cargo or just merely, as in this case, because it was a piece of the cargo that caused the damage, it is not necessary that we prove the cargo was in the area. The operation being done aboard the vessel at the time by the United States Government and in their acts which we claim were negligent are sufficient to permit us to sue the vessel under the Suits in Admiralty Act by this means of a libel in personam.

Now, that was the problem we were facing, as to whether or not the vessel's presence is material, and also whether or not the absence of cargo from this area is fatal.

Mr. Staring: May I clarify one thing, your Honor, which has arisen?

The Court: You may.

Mr. Staring: I think we have fallen into a pit-



fall. We are talking here a little too much as to whether this is a suit in rem against vessel or cargo. I'm not trying to elect for Mr. Holland or Orion whom he is suing and what for. Our position is simply that if there is a suit against the United States, it must be brought where the Act says.

Now, if Mr. Holland is charging the cargo with liability, then it can't be brought here, if he [23] is charging that that is the basis of his venue. If he is charging neither ship nor cargo, then he has left only the residence of the third party plaintiff, which is in New York, and if he is claiming his venue on the basis of charging the ship with liability, he gets into the curious position of saying that the government was somehow negligent in operating the Sea Coronet when the evidence shows that in fact Orion was operating it and the judgment against Orion has proceeded on the basis that Orion was negligent in operating it.

Now, what kind of legal abracadabra is this, that you can operate your ship negligently and then by some legal fiction claim that somebody else was negligent and claim over from them?

Mr. Holland: I will just say, your Honor, that the jury did not say whether or not their verdict was based on negligence or on unseaworthiness.

In answer to Mr. Staring's argument, it could well have been based on unseaworthiness which was a condition caused by the government and which could well have been not from any negligence on the part of the vessel, so we're not saying in the

same breath that the vessel isn't negligent and that the government is. [24]

The Court: The Court believes, no matter what the reason is, that under the Ryan case doctrine this action over properly lies and that it is properly a suit so far as venue is concerned that may be placed on the provisions of the Suits in Admiralty Act, and that whatever it was that plaintiffs were suing for against the defendants in the plaintiff's jury action, the doctrine of the Ryan case is that for that there is a remedy over case, it is the kind of a cause of action as to which the Ryan case says there is an action over, and that in so far as the plaintiffs asserted and the jury could have taken the view that the offending thing in the process or one of them was the cargo itself, and I personally think under the evidence it was, that there isn't any question but what the government's cargo, having been once here, as was said by Mr. Staring,—

Mr. Staring: No, your Honor, I never said that. It has never been here. The cargo has never been here.

The Court: Has the vessel been here?

Mr. Staring: The vessel without the cargo has been here, but the cargo has never been here.

The Court: Either one. I thought you said the cargo had been here. [25]

Mr. Staring: No. I may explain for the record now that the cargo was discharged in Japan and has never been here.

The Court: The vessel was here and it was one

of the things with respect to this cargo and its carriage was in operation according to the evidence which was submitted to the jury, and the Court overrules the objection. The Court on the theory of immateriality asserted by the objector overrules the objection, the Court believing that the answers to the requests for admissions are or might be material.

Mr. Holland: As I understand your Honor's comments, I need not argue then the alleged lack of venue under the Suits in Admiralty Act or the applicability of that Act to this claim for——

The Court: I thought we just disposed of that.

Mr. Holland: Yes, that's my understanding, your Honor.

The Court: I thought we just disposed of that.

Mr. Holland: Yes. Then, your Honor, I think in view of that we need only discuss the evidence as respects the alleged liabilities of the two parties.

The Court: As bearing on the question of [26] the right to have these requests——

Mr. Holland: No, no, your Honor, on the main question of——

The Court: That is, the merits.

Mr. Holland: Yes, your Honor.

The Court: I don't know what the record is as to what you are presenting to the Court in the way of facts. I don't know what the record is on which you seek to argue now just before submission of the case.

Mr. Holland: Oh. Well, your Honor, in view of the government's admission on the genuineness

of the time charter party may we have marked the photostatic copy which is in the file and which was a part of that admission.

The Court: Just a minute. Does either litigant in this third party action over wish to make an opening statement of what the proof will be?

Mr. Staring: No, your Honor.

The Court: Do you, Mr. Holland?

Mr. Holland: Very briefly, your Honor.

The Court: Do it now.

Mr. Holland: I'll make that now. Your Honor, the respondents Orion and Pacific Cargo Carriers will show in their evidence that the negligence if any [27] of the respondents, the vessel operators, was only in the lack, as alleged in the plaintiff's complaints, the lack of the security watch and the insufficient time during which the men were not given warning to leave the vessel.

The evidence will show that immediately after having been advised of the presence of the gas Mr. Mitchell, the security watch on board the vessel who at the time was on his rounds, immediately went to the Third Mate; that the evidence will show the Third Mate immediately went to the Chief Mate; that the Third Mate then rang the alarm bell and the men were warned to leave the vessel.

On the appropriateness of the security watch the evidence will show or the evidence has already shown that the normal port security watch was on the vessel that night between the hours of 4:00 to 12:00 and that it consisted of the Third Mate who



was on watch and Mr. Mitchell who was the seaman who was on watch as part of that security watch.

The evidence will show or has already indicated that the entire operation being carried on at the hatch where the gas escaped was being done by the Army and that the ship had no duties whatsoever in connection with the loading of that cargo. [28]

I think the evidence will show that these are the facts which are to be considered by the Court in determining whether there is a right to full indemnity.

The Court: The third party respondent may now make its opening statement if it wishes to, or it may reserve it or it may entirely waive it.

Mr. Staring: If your Honor please, I would like to reserve all statements until the time of argument.

The Court: What is it then in connection with the proof that you are going to offer? I would like to know what it is that is answered in response to this request. Where are the requests for admissions? I want to see the one as to what is asked about whether or not the vessel or the cargo has been in this District. As the Court has already indicated in the Court's last remarks in response to the corrective statement that Mr. Staring made about the presence of the cargo or the lack of presence of the cargo in this District, it makes no difference which one was present if either one was, and that is admitted. In my opinion the Court has jurisdiction of this third party over action against the United States.

Mr. Holland: If the Court please, that is [29]



being introduced at this time, as I indicated, by a stipulation with Mr. Staring that such was the fact.

The Court: What is it that is the fact, that the vessel was here or the cargo was here, or both?

Mr. Holland: That the vessel was here during the pendency of the action. That is the stipulation.

The Court: It should have been here at the time of the commencement of the action, should it not, if jurisdiction is founded upon——

Mr. Holland: No.

Mr. Staring: That would be our position, your Honor, and I reserve our position on that.

The Court: You either have to have the thing here or you have to have the United States as the owner of the thing here. and the time when the thing was here that is important is the time of the commencement of the action, like in any other in rem proceeding. Is that not true?

Mr. Holland: No, your Honor, that is not true. First of all, this is not an in rem proceeding, and as stated in the brief which we filed initially in answer to the government's motion, in *W. R. Grace and Company*, for example, it is stated that an action [30] will lie under this Act although the vessel has disappeared, and there are other cases which state that if it is in the area at any time during the pendency of the action it is sufficient to establish jurisdiction.

The Court: Isn't one of the material allegations of the libel that the vessel or the offending thing is within the jurisdiction of the Court? Isn't that

one of the material allegations under the Suits in Admiralty Act?

(No response.)

The Court: I ask you if one of the material allegations of the Suits in Admiralty Act is not, where it is with respect to the in rem liability of an offending thing like a ship, one of the material allegations is that the ship is now present in the district?

Mr. Holland: With respect to an in rem proceeding, your Honor, it is necessary that such be alleged. With respect to an in personam proceeding such as this——

The Court: I am talking about under the Suits in Admiralty Act where you sue the United States in lieu of the offending thing.

Mr. Holland: Yes. This is an in personam [31] proceeding.

The Court: Does not the Suits in Admiralty Act say that you sue where the offending thing or where the vessel is?

Mr. Holland: That is correct.

The Court: Do you say that in this case?

Mr. Holland: I do not say it is necessary to allege that fact, your Honor. That fact is now in evidence, the fact that it was in the district.

The Court: At some time during the pendency of the action?

Mr. Holland: Yes, your Honor, that is correct.

The Court: Which makes the allegation true, is that—well, maybe it wasn't true at the time it was made but it became true during the pendency?

Mr. Holland: It is our contention, your Honor, that it may not even be alleged in an in personam proceeding, and it is the evidence now, your Honor, that the vessel was in the district.

Mr. Staring: May I have a moment, your Honor, to consult the amended third party complaint?

Th Court: Yes, you may.

(Brief pause.)

The Court: This reminds me of the trial [32] judge who thinks he has some experience in admiralty matters and one of the most experienced admiralty lawyers in this city the other day not remembering clearly whether or not the third party respondent under Rule 56 in a recovery over proceeding becomes liable to a libellant if he appears and answers, as he is required to, the libel.

Mr. Staring: Your Honor, in the amended third party complaint filed in these cases there is no allegation of any location of the ship whatsoever nor any indication that venue is being based upon the location of the ship.

Now, it is held under the Act, as your Honor correctly recalls, that venue has to be pleaded, you have to show the basis under which you bring your action in this district. There is no mention of that. There is no mention that either ship or cargo was here, and certainly no mention that Orion Shipping and Trading lives here, which it is admitted not to be. The vessel was not mentioned and the cargo was not even mentioned in this suit as being here.

Mr. Holland: In conformance with the proof

which is now before your Honor then, if that be the case, the respondent would move to amend their third party complaints to allege that the vessel was present [33] in this district during the pendency of the action.

Mr. Staring: I would object to such an amendment at this stage of the proceedings.

The Court: Was it received without objection at the time it was offered?

Mr. Holland: It was, your Honor, and there was no objection as to the absence of such an allegation. Comments were made by government Counsel that the cargo was not present. No contention was made by Counsel that the vessel was not present, to my recollection, in their briefs, and they certainly are not surprised by our now moving to amend.

Mr. Staring: If your Honor please,—

The Court: If the record now shows, no matter whether by an admission to a request for admission or whether it is shown by someone's testimony, some witness' oral testimony, or whether it is shown by some document, if it is now in the record without any objection from the United States of America at the time it went into the record—

Mr. Staring: Your Honor, I made the—

The Court: —why then I assure you that it would be in my opinion error for the Court not to grant the amendment, because it is already made by operation of law. [34]

Mr. Staring: Your Honor, the only time that the matter has gone into the record was here this morning when objection was made by me and fully



argued to your Honor that it was irrelevant and immaterial that the ship was in this district.

Now let me say that last year, when motions to dismiss in these cases were argued to your Honor, one of the grounds of the motion made was the failure to allege facts showing venue in this district, and I understand it is not necessary to repeat that in an answer. The motion was denied and the point is preserved, and now at this point they seek to amend and allege a new ground of venue, and the only evidence on it was objected to by me here this morning because it was not based on anything in the pleadings.

The Court: I did not understand that it was on the insufficiency of the venue allegation. I thought you based it on the fact,—put in this way, my understanding of your position was that it was not clear that he was suing the United States in personam in lieu of the offending thing which has been within the jurisdiction.

Mr. Staring: No, my objection was that the bringing of the ship into the jurisdiction, which I said at the time I suppose Mr. Holland is interested [35] in proving that the purposes of venue, and I said, “I don’t think it has anything to do with venue and it is irrelevant and immaterial.” It is based on the venue provision of the Suits in Admiralty Act only is why I objected, and I tried to make it clear later not on any supposed distinction between in rem and in personam under the Suits in Admiralty Act.

Mr. Holland: It was my understanding, your



Honor, that the objection was because it was Counsel's opinion or thought that we were suing the cargo and that therefore the presence of the vessel was immaterial. That was my understanding.

Mr. Staring: I got up and corrected that.

The Court: I am not going to take any chance on construing over the objection of objecting Counsel what he meant by an objection. He objected to the venue this morning before he effectively made this admission in response to the requests for admissions, and I don't think the Court has a right to say now that the aspect of his objection to jurisdiction was not the one that is now in question. I just don't think that is right. I don't think the Court could truthfully say that the record now shows without objection from the third party defendant United States that the vessel was in the jurisdiction during the [36] pendency of this action, Mr. Holland. I don't see it. I don't see that in the record. If there had been some witness on this stand or if there were some evidence equivalent to it who without any objection from Mr. Staring had said, "Well, I went aboard that vessel in Elliott Bay the second day after that action to recover over was filed," and Mr. Staring never had objected to it at all, why then in my opinion Mr. Staring for the third party respondent could not be heard to object now that it was not proved. The record in my opinion would in that situation show a fact which in and of itself by operation of law amend the pleadings, because the law in this jurisdiction says, in state practice and this federal practice also which follows the

state practice in that respect, that if a fact is proved, even though it is not specifically alleged in the pleading, thereupon the pleading by operation of law becomes so amended in accordance and in harmony with such fact. I cannot say that here because he has been objecting to your right to prove the venue by his admission in this fashion on the ground that he said that it was not within the pleading. He has said that here this morning.

Mr. Holland: Well, if the Court please, the purpose of our attempted stipulation was to save the [37] time of the Court and have a witness who was prepared to come up and so state, and as far as the proceeding here it may be treated just as though the witness were here, with the agreement of Mr. Staring, as though the witness were here and did so testify.

The Court: That is for Mr. Staring to say. That is not in the record.

Mr. Holland: Well, Mr. Staring stipulated that the witness would come and so testify. He, however, made his objections, which was proper.

Mr. Staring: I objected that it was irrelevant and immaterial. I said if the Court ruled against me that it was relevant upon some basis found in the pleadings, why then I would agree to save the time of the witness, but the so-called stipulation is subject to the ruling of the Court.

The Court: Again I have no right to say what each Counsel understood his own oral words to be. Counsel made a mistake not to have it in writing. If you had it in writing I would have some right

to say what the written words mean, but I cannot say what Counsel in their oral words meant to say about a thing of this sort. I don't believe the Court has any right to, especially if there is a dispute about what the oral words exactly were. It is just too risky a thing [38] for the Court to assume the responsibility to say whose recollection is right as to what the words were or what they meant. It isn't right, and I don't see any allegation here, in view of the state of the pleadings, that that vessel was here during the pendency or that the cargo was here during the pendency of the action. Where are the words that say that?

Mr. Holland: There are no such, your Honor.

The Court: And those words are not in the statement of allegations as to venue unless the pleading of the third party plaintiff is amended by an answer which was made under compulsion and over the objection of the third party respondent on the basis, among other things, that the venue was improper and was immaterial on the question of the allegation of venue. One of the first things Mr. Staring said this morning was that it was immaterial on the question of venue because of something like the cargo not being here. It seems to me that he then, though, did he not, admit that the ship was here?

Mr. Holland: Your Honor, the thing we are attempting to stipulate is merely to a fact, and that fact is that the vessel was here during the pendency of the action. Now, Mr. Staring agrees with that fact because to save the time of a witness

coming and [39] advising the Court of that fact. Beyond that he reserves all his objections.

The Court: Mr. Staring, did you not say, "I admit the ship was here?" Either that or you said—I thought you said the cargo was here, but you say it was not, and now you admit that the ship was here.

Mr. Staring: The record will show, your Honor, that my position was that I did not wish—if it were relevant and if Mr. Holland produced the testimony, I wasn't going to put him to the trouble of bringing his witness. I objected to any such proof on the grounds of irrelevancy and immateriality, and I said if I am overruled on such grounds I will agree that the ship came in here, if I am overruled.

The Court: Very well. It may be a very serious thing, but it is not half as serious as the Court running the risk of granting a judgment or granting relief to a suing party against one who objects to being sued and if that party contends, with some reason and with the state of the record to back him up, that there is no allegation nor any unobjected proof to support the venue of this Court.

Mr. Holland: We would then renew our motion to amend, your Honor, for the reason that no surprise comes to the government as the result of the present [40] inclusion of such an allegation if the Court deems such allegation necessary, which we do not believe is correct, but if deemed to be necessary we would then move to amend at this time, and I don't believe the government can show any preju-



dice or any surprise, since they have been present throughout the trial and throughout this case.

Mr. Staring: I will say I am surprised in just this alone, that I am surprised to find this matter being argued here this morning. I feel that at this time in the case we should at last have known under what jurisdiction we were proceeding and what this claim consisted of.

The Court: The Court finally sustains the objection to the trial amendment that was asked for to make the pleadings conform with the proof in view of the fact that all the proof is in a form of admission which was made over the objection of the admitter, namely the third party respondent United States of America, and one of the objections was that the answer to the request for admission if made would be immaterial because there was nothing in the then present state of the pleadings to make it material, and the present motion for trial amendment is denied because it is just tardily made. If Counsel were some inexperienced [41] pleader, some young man just out of law school, the Court might not take this view, but there are too many things connected with the case. Counsel could have looked the situation over the next day after these jury verdicts when he must have been faced with a decision as to whether he seriously should attempt to sue over against the United States of America, and he has had the time since the jury's verdicts until now to attempt to get his pleadings into condition and to bring any questions preliminary to it on for trial. It just isn't right.



What is the reason for the Court entertaining this action any further? Is there any reason why it should not be dismissed?

Mr. Staring: I know of none, your Honor.

Mr. Holland: If the Court please, the respondents at this time would move to be permitted until two o'clock to offer proof of the proper venue in this case.

The Court: You may put in the record your offer of proof.

Mr. Staring: And I will object to that.

The Court: The Court will accord you that opportunity, Mr. Holland.

Mr. Holland: At two o'clock? [42]

The Court: No, at 1:30. How long will it take?

Mr. Holland: The witness will just take one minute, your Honor.

The Court: Then just about five minutes before 2:00.

Mr. Holland: Five minutes before 2:00?

The Court: Yes.

Mr. Holland: Thank you, your Honor.

Mr. Staring: Do I understand that your Honor has not ruled that the evidence will be admitted but only that the offer may be made?

The Court: I say that he may have a right to make his record showing what proof he wishes to make will be. In other words, he may have an opportunity to make a record of his offer.

Mr. Staring: I understand, your Honor. Is it your Honor's order that the third party actions are to be dismissed?

The Court: That will be the order of the Court.

Mr. Staring: If so, may I prepare——

The Court: Will you present an order at that time?

Mr. Staring: May I present orders this [43] afternoon?

The Court: Yes.

Mr. Staring: Thank you, your Honor.

Mr. Holland: Would your Honor wish to hear argument under the Federal Torts Act, which is the alternative remedy sued upon here?

The Court: I thought everything was based on the Suits in Admiralty Act.

Mr. Holland: We plead alternative statutes, your Honor.

Mr. Staring: Your Honor will remember the case which your Honor decided a year ago in December of Reed vs. United States which turned upon the mutual exclusiveness of the Suits in Admiralty Act and the Tort Claims Act, and you will remember that your Honor dismissed for lack of jurisdiction under the Torts Act.

The Court: That was the hospital case.

Mr. Staring: That was the hospital case, because jurisdiction could have been had under the Suits in Admiralty Act. It's not only the decision of the Supreme Court on the Suits in Admiralty Act by itself that is exclusive, but it is set forth again to make doubly sure in the Tort Claims Act that if you can bring suit under the Suits in Admiralty Act you cannot bring suit under the Tort Claims Act. You have [44] to make a choice.

The Court: The Court will apply that rule here. Is there anything else to be said? Court will be recessed until 1:55 this afternoon.

There is one thing further I would like to say on the record, gentlemen. I am more content to make this ruling and better satisfied with the result thereof even though it may be a hardship on the third party plaintiffs suing over because after all there is some arguable objection to the propriety of the Court's maintaining this action in this situation, and the risks which the suing party, the party suing over, is taking by trying to obtain relief in this court, even if he should be successful, is so very serious that it makes the Court feel more content with the result of this ruling just announced because it is without prejudice to the right of these third party plaintiffs to sue the third part respondent United States of America in the proper district and in the proper venue.

Court is now recessed until 1:55 this afternoon.

(Thereupon, at 11:10 o'clock a.m., a recess herein was taken until 1:55 o'clock p.m.) [45]

Friday, July 27, 1956, 1:55 o'clock p.m.

(All parties present as before the noon recess.)

The Court: You may proceed in the case on trial if you are ready. Are all parties ready?

Mr. Staring: Yes, your Honor.

The Court: The case in which we were going to settle an order. Do you have an order that is approved as to form?

Mr. Holland: If the Court please, your Honor will recall that I was going to put on a witness.

The Court: You were going to make an offer of proof.

Mr. Holland: Yes.

The Court: You may do that now.

Mr. Holland: Mr. Wesson, will you take the stand, please.

### LEONARD C. WESSON

called as a witness in behalf of defendants and third party plaintiffs, being first duly sworn, was examined and testified as follows:

#### Direct Examination

Q. (By Mr. Holland): Will you state your name, please? [46]

A. Leonard C. Wesson.

Q. Will you spell that?      A. W-e-s-s-o-n.

Q. What is your occupation, Mr. Wesson?

A. I'm industrial relations representative for the Alaska Steamship Company.

The Court: Now make an offer of proof. I haven't time to hear the testimony.

Mr. Holland: If the Court pleases, the respondents make the offer of proof that this witness will testify that in the latter part of 1953 the SS Sea Coronet was purchased by Alaska Steamship Company from Orion Shipping and Trading Company; that the vessel was renamed the Tonsina, and that since the latter part of 1953 up to the present time that vessel has been in and out of the Port of Seat-

(Testimony of Leonard C. Wesson.)

tle on its regular run for Alaska Steamship Company. That concludes the offer of proof.

Mr. Staring: I will object to such proof upon the grounds of irrelevancy and immateriality.

The Court: The objection is sustained.

Mr. Holland: No further questions.

The Court: You may step down, Mr. Wesson.

The Witness: Thank you.

(Witness excused.) [47]

Mr. Staring: Your Honor, I have prepared an order and I have submitted it to Mr. Holland at this time.

Mr. Holland: If the Court please, in view of this matter having developed this morning, over the noon hour the respondent found two District Court cases in which this identical situation occurred in which the libel failed to allege the elements of venue and in which cases the Court—

The Court: I do not wish to hear further argument. The ruling will stand, unless you have a Supreme Court decision or a Circuit Court decision, Mr. Holland.

Mr. Holland: May I then state, your Honor, that the respondents before the entry of this order would move the Court under 28 U. S. C. A., Section 1406, that this matter, rather than being dismissed at this time, be transferred to the proper district. 1406-A reads that, "The District Court of a district in which is filed a case laying venue in the wrong division or district shall dismiss, or if it be in the interests of justice, transfer such case to any district



or division in which it could have been brought," and——

The Court: I do not see what would be gained by a transfer. [48]

Mr. Holland: For the reason, your Honor, to expedite the eventual settlement of the entire problem, that the matter would need not then be refiled in the Southern District of New York but may merely be transferred to be placed on their calendar for further handling.

Mr. Staring: If your Honor please, may I show your Honor what would happen to it upon its arrival in the Southern District of New York?

The Court: You don't need to show it. I don't see anything to be gained by the transfer. I don't understand what the difference is or any advantage to anyone by transfer or dismissal. Dismissal is without prejudice to starting the action tomorrow. There has not been anything done here that won't have to be done there all over again, so far as I can tell. What is there to be gained by transfer that would not be accomplished by bringing suit?

Mr. Holland: In the interests of justice, as the rule says, your Honor, the question of time, the respondents would not be permitted to institute their suits on the east coast until after the final result of the appeal in this case and until after the amounts and judgments have been paid. Suit cannot be brought at this time and would be premature because the respondents until such payment have not been damaged by the acts of the government, and any suit up to that time would be dismissed as prema-

ture. If, however, since they are in this impleading petition, it is transferred there for further handling, the matter could be carried on the calendar depending upon what would happen in the appeal.

The Court: Have you any authority for transferring an action over?

Mr. Staring: I've never heard of its being done, your Honor, and I call to your Honor's attention a recent decision of the Southern District of New York——

The Court: No, I do not care to hear it. I do not wish to transfer it. I wish to dismiss it, because it was improperly brought here, in my opinion.

Mr. Holland: If the Court please, as to the wording of this order, the respondents would request that the words "without prejudice" be inserted.

The Court: The Court wishes affirmatively that it be so worded, and the Court will undertake to put in the proper words at the proper place. Where do you suggest?

Mr. Holland: After the word "without on Line 2, Page 2, the words inserted "prejudice and without". [50]

The Court: "are hereby dismissed without prejudice and" is where I think it would be proper. Mr. Staring, have you enough copies of this order to file one copy in each of the other suits other than——

Mr. Staring: Yes, your Honor, we have copies for every file here and I am conforming them with the changes.

The Court: It seems like everyone who writes the names of these cases writes them in a different

order. I have never seen them written in this order before. I don't see why someone wouldn't have put either the smallest numbered case at the top of the list or else put the Aregood case at the top of the list.

Mr. Staring: I'm afraid, your Honor, we have fallen into the habit of following some pleading file along the line without being very critical of it and have continued to——

The Court: I wish you would file this order in the Aregood case, No. 3623, and then I wish you to file a copy, it can be an uncertified copy as far as I am concerned, I wish you to file a complete typewritten copy in every one of these other cases.

Mr. Staring: Yes, your Honor, as soon as I have made the change which—— [51]

The Court: Will you do it today?

Mr. Staring: ——your Honor has done I will immediately hand them to the clerk today.

The Court: Will you make that filing today?

Mr. Staring: I will make it within the next few minutes, your Honor.

The Court: And then if you have copies of everything except the Judge's name, have every word of the order except the Judge's name, you can write that in in longhand if you put the word or the sign for the word "signed" before the name. Just indicate that it is a copy.

Is there anything else which the Court should consider in this particular matter?

Mr. Staring: Nothing further, your Honor.

The Court: Those connected with this case are excused.

(Thereupon, at 2:05 o'clock p.m., an adjournment herein was taken.) [52]

[Endorsed]: Filed Sept. 13, 1956.

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[Title of District Court and Causes.]

\* \* \* \* \*

### COURT'S ORAL OPINION

The Court: The Court now, as previously, is of the opinion that to grant the motion to transfer under the statute cited, 28 U. S. C. Section 1404 (a), would permit any litigant in the future to have a precedent for sitting by and letting the statute of limitations run in the district of jurisdiction after he willfully but wrongfully instituted an action in the wrong venue. Such a doctrine has never prevailed before, and it was not intended to prevail under this statute.

The running of the statute of limitations is a peril which every suitor has facing him when he selects, and it has always been so. In the past if, he selected the wrong forum, one not having jurisdiction, that did not toll the statute.

It seems to me to be wholly inconsistent with justice to permit any such result as that. Even in this case it could have been in the mind of the one suing over, although I do not believe it was, that it chanced the running of the statute while it had [2] knowingly chosen the wrong forum, upon the theory that Section 1404 (a) would apply and rescue the

party suing over from its own willful choice of the wrong forum, and if, as I believe, such an attitude was not considered and was not possessed by this party, nevertheless if such attitude had in fact been possessed, according to the theory of this party suing, over, it would be entitled to the same relief anyway which it here seeks, namely the right to transfer to the proper jurisdiction notwithstanding any such, if it were so, willful choosing of the wrong forum.

The Court adheres to its former ruling and denies each and all of these motions.

\* \* \* \* \*

[Endorsed]: Filed November 15, 1956.

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[Endorsed]: No. 15264, United States Court of Appeals for the Ninth Circuit. Orion Shipping and Trading Company, a corporation, and Pacific Cargo Carriers Corporation, Appellants, vs. United States of America, Appellee. Transcript of Record. Appeals from the United States District Court for the Western District of Washington, Northern Division.

Docketed: September 5, 1956.

Filed: August 23, 1956.

/s/ PAUL P. O'BRIEN

Clerk of the United States Court of Appeals for  
the Ninth Circuit.



In the United States Court of Appeals  
for the Ninth Circuit

No. 15260

ORION SHIPPING & TRADING COMPANY,  
INC., Appellant,

vs.

WILLIE B. HOLMES, and UNITED STATES  
OF AMERICA, Appellees.

No. 15261

ORION SHIPPING & TRADING COMPANY,  
a corporation, Appellant,

vs.

CHARLES E. AREGOOD, and UNITED  
STATES OF AMERICA Appellees.

No. 15262

ORION SHIPPING & TRADING COMPANY,  
a corporation, Appellant,

vs.

GEORGE E. LEWIS, and UNITED STATES OF  
AMERICA, Appellees.

No. 15263

ORION SHIPPING & TRADING COMPANY,  
a corporation, Appellant,

vs.

JOSEPH E. MITCHELL, and UNITED STATES  
OF AMERICA, Appellees.

No. 15264

ORION SHIPPING & TRADING COMPANY,  
INC., and PACIFIC CARGO CARRIERS  
CORPORATION, Appellants,

vs.

WILLIE B. BASNIGHT, and UNITED STATES  
OF AMERICA, Appellees.



It Is Further Stipulated that the final judgment between appellants and appellee United States of America in the said cause No. 15264 be considered to be the law of the case in each of the other causes consolidated hereby as to all issues between appellants and appellee United States of America raised by the record in the said cause No. 15264.

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/s/ J. DUANE VANCE

Attorneys for Appellees Willie B.  
Basnight, Arthur G. B. Morriss,  
and Ben Wilcox.

ORDER

Upon consideration of the foregoing stipulation for consolidation of causes,

It Is Hereby Ordered that the above causes be consolidated for hearing on appeal; that appellants need designate as the record which is material to the consideration of the instant appeals against appellee United States of America only portions of the record in Orion Shipping & Trading Company, Inc. and Pacific Cargo Carriers Corporation vs. Willie B. Basnight and United States of America, No. 15264; and that the final judgment between appellants and appellee United States of America in the said cause No. 15264 be considered to be the law of the case in each of the other causes consolidated hereby as to all issues between appellants and appellee United States of America raised by the record in the said cause No. 15264.

Dated October 23, 1956.

/s/ WILLIAM DENMAN

Chief Judge

/s/ WILLIAM HEALY

Circuit Judge

/s/ WALTER L. POPE

Circuit Judge

[Endorsed]: Filed October 25, 1956. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Causes Nos. 15260, 15261, 15262, 15263, 15264, 15265, 15266.]

## STATEMENT OF POINTS

Come Now the appellants and pursuant to Rule 17 (6) of the Rules of the Court of Appeals for the Ninth Circuit and hereby make the following Statement of Points:

1. The District Court erred in sustaining the objection to the trial amendment requested to make the pleadings conform to the proof with respect to venue.

2. The District Court erred in sustaining the objection to the offer of proof concerning venue.

3. The District Court erred in denying the motion to transfer the third party action under the provisions of 28 U.S.C.A. 1404 (a).

4. The District Court erred in dismissing the third party complaint on the ground of lack of venue.

\* \* \* \* \*

BOGLE, BOGLE & GATES  
Attorneys for Appellants.

Acknowledgment of Service Attached.

[Endorsed]: Filed November 9, 1956. Paul P. O'Brien, Clerk.





No. 15264

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**United States Court of Appeals**  
**For the Ninth Circuit**

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ORION SHIPPING AND TRADING COMPANY, a Corporation,  
and PACIFIC CARGO CARRIERS CORPORATION,  
*Appellants,*

vs.

UNITED STATES OF AMERICA, *Appellee.*

---

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR  
THE WESTERN DISTRICT OF WASHINGTON,  
NORTHERN DIVISION

---

**BRIEF OF APPELLANTS**

---

BOGLE, BOGLE & GATES  
ROBERT V. HOLLAND  
*Attorneys for Appellants.*

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No. 15264

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United States Court of Appeals  
For the Ninth Circuit

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# United States Court of Appeals

## For the Ninth Circuit

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ORION SHIPPING AND TRADING COMPANY, a Corporation, and PACIFIC CARGO CAR- RIERS CORPORATION,	<i>Appellants,</i>	} No. 15264
vs.		
UNITED STATES OF AMERICA,	<i>Appellee.</i>	

---

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR  
THE WESTERN DISTRICT OF WASHINGTON,  
NORTHERN DIVISION

---

### BRIEF OF APPELLANTS

---

#### STATEMENT OF JURISDICTION

Willie B. Basnight, a crew member of the S.S. SEACORONET, filed a civil action in United States District Court for the Eastern District of Pennsylvania against Orion Shipping & Trading Company and Pacific Cargo Carriers Corporation, owners and operators of the vessel, for injuries received aboard the vessel on August 17, 1953. The cause was transferred to the United States District Court for the Western District of Washington, Northern Division. The defendants then instituted a third party action against the United States of America with a claim for recovery over against the Government for any amounts the defendants might be required to pay Willie B. Basnight.

The case came on regularly for trial before the

Honorable John C. Bowen. A verdict was rendered by the jury on behalf of Willie B. Basnight and against Orion Shipping & Trading Company and Pacific Cargo Carriers Corporation and a judgment entered thereon. The trial court dismissed the third party complaint against the United States of America and denied a motion to transfer the said third party action to a different venue. The defendants appealed from the judgment in favor of Willie B. Basnight and also appealed from the judgment of dismissal of the third party action and the order denying the motion to transfer the cause. Subsequently the judgment in favor of Willie B. Basnight and against Orion Shipping & Trading Company and Pacific Cargo Carriers Corporation was satisfied and the appeal thereon was dismissed. Appellant Orion Shipping & Trading Company and Pacific Cargo Carriers Corporation prosecutes this appeal from the judgment of dismissal of the third party action and the order denying the motion to transfer the same.

## JURISDICTION OF THE DISTRICT COURT

The jurisdiction of the District Court of the main cause of action of *Basnight v. Orion, et al.*, is conferred by the provisions of Title 28 U.S.C.A. 1332. The jurisdiction of the District Court with reference to the third party cause of action is conferred by the Suits in Admiralty Act, 46 U.S.C.A. §§741-752. For the jurisdiction of the District Court of the third party action on the *civil* side see *Skupski v. Western Navigation Company*, 113 F.Supp. 726 (D.C.S.D.N.Y. 1953). In that case the vessel was owned and operated by the defend-

ant third party plaintiff, and was time chartered to the United States. In an action by the widow of a longshoreman accidentally killed aboard the vessel, the vessel owner impleaded the United States under the Federal Torts Act. The government moved against the third party complaint on the ground that a remedy was available under the Suits in Admiralty Act and that therefore the Torts Act (28 USCA 2680(d)) precluded the application of the Torts Act. The court decided as follows (p. 727):

“Without indulging in jurisprudential semantics, it seems clear that the sovereign consent to be sued manifested in the Federal Tort Claims Act includes impleading the United States. *United States v. Yellow Cab Co.*, 340 U.S. 543, 71 S.Ct. 399, 95 L.Ed. 523. If it had been possible and had plaintiff maintained the parent action under the Suits in Admiralty Act, consent to sue the United States would have included its impleader in admiralty. *Hidalgo Steel Co. v. Moore & McCormack Co., Inc.*, D.C.S.D.N.Y., 298 F. 331; *The Cotati*, D.C.S.D.N.Y., 2 F.2d 394. The question presented—somewhat different in this case—is whether such impleader of the United States may take place when the parent action is one on the civil side and the right of such defendants against the sovereign is one of admiralty.

“We think that such impleader lies. In the words of Judge Cardozo, ‘No sensible reason can be imagined why the state, having consented to be sued, should thus paralyze the remedy.’ *Anderson v. John L. Hayes Construction Co.*, 243 N.Y. 140, 147, 153 N.E. 28, quoted in *United States v. Yellow Cab Co.*, *supra*, 340 U.S. at page 554, 71 S.Ct. 399, 406. Third party practice has been designed



to assure disposition of disputes with common questions of law and fact in a single suit and not a multiplicity of them. That the remedy against the third-party defendant in the instant case may properly be sought in admiralty without jury, and—on the other hand—that against defendants is sought in a forum with jury, presents no insuperable barrier to pursuit of both in a single suit. After trial, the court might reserve to itself disposition of the controversy involved in the third-party complaint and leave to the jury issues of fact presented by the original complaint.

“Motion by the United States to dismiss the third-party complaint denied.”

The United States itself, as defendant in a Federal Torts Claim action, has impleaded a third party in a *civil* action for a *maritime* claim and has succeeded in taking such action over the objection of the third party defendant that the third party complaint did not constitute a good cause of action on the *civil* side in view of the occurrence having been maritime in nature. See *Russell Poling & Company v. United States*, 140 F.S. 890 (U.S.D.C. S.D. N.Y. 1956). This was an action by plaintiff on the civil side under the Federal Tort Claims Act. The United States impleaded a third party defendant. The court found that both the principal and the third party claim were maritime in nature and stated that the fact that the suit was pending on the law side rather than the admiralty side of the court did not deprive the third party defendant from asserting its claim for a division of damages as a substantive right. The court stated (p. 893):

“The trier of the fact may well find that the

damage caused the plaintiffs' barge was due to common fault — negligent towage by Conners (third party defendant) and negligence of United States of America with respect to the proper maintenance of the light buoys. Since under applicable admiralty law, Conners, if found to be in fault with United States of America, may be called upon to exonerate the latter for one-half of the damages, it was properly brought in as a third party defendant under Rule 14 (a)."

The same court held similarly in *Canale v. American Export Lines*, 17 F.R.D. 269 (U.S.D.C. S.D. N.Y. 1955). Judge Kaufman stated (p. 270) :

"The crucial issue posed is whether a third party complaint may be brought in admiralty when plaintiff's action against the defendant is one of law. While the question is not free from difficulty, this court holds in the affirmative."

The court states that what is essentially at issue is the extent to which an admiralty cause triable without a jury and civil actions at law with trial by jury may be joined for the purposes of a single suit. The court states that the separation of the fact finding functions of the jury and the trial judge in such a case does not lead to confusion and has consistently been effectuated in cases where issues of law are tried to a jury and issues of an equitable nature in the same case tried by a court alone. This is the precise procedure employed by the trial court in the case at bar (Tr. 51, 52). Judge Kaufman then proceeded to review the cases including those from the Second and Third Circuits in which maritime causes of action were heard by the courts in conjunction with actions on the law side of the court,

such as for example Jones Act cases at law being tried together with maintenance and cure cases in admiralty. See *Civil v. Waterman S. S. Corp.*, 217 F.(2d) 94, 97 (C.A. 2, 1954), and *Jordine v. Walling*, 185 F.(2d) 662 (C.A. 3, 1950). Further example of this authorization of joinder at law of a personal injury claim and a maritime cause of action is given by *McCarthy v. American Eastern Corp.*, 175 F.(2d) 724 (C.A. 3, 1949), wherein the court treated a claim based both on negligence and unseaworthiness. Judge Kaufman also quotes at length from the *Skupski* case, *supra*. In conclusion Judge Kaufman states (p. 273):

“It is in the interest of expedition and consistent with the spirit of modern pleading that artificial practice barriers be pierced.”

## **JURISDICTION OF THE COURT OF APPEALS**

Jurisdiction of this Court is granted by the provisions of Title 28 U.S.C.A. §1291 which gives to the Courts of Appeal jurisdiction of all appeals from final decrees of District Courts.

## **STATEMENT OF THE CASE**

On August 17, 1953, Willie B. Basnight was a member of the crew of the S. S. SEACORONET, owned and operated by Orion Shipping & Trading Company and Pacific Cargo Carriers Corporation. On that date the vessel was under time charter to United States of America and was in the course of cargo operations at the Army Port of Pusan, Korea. Army scrap metal parts were being loaded aboard the vessel among which were some presumably empty containers of chlorine

gas. During the course of the evening on that date chlorine gas began emanating from the hatch of the vessel as a result of which the plaintiff Basnight was exposed to the fumes and sustained certain alleged injuries.

Basnight filed a civil action against Orion Shipping & Trading Company and Pacific Cargo Carriers Corporation in the United States District Court for the Eastern District of Pennsylvania on September 20, 1954 (Tr. 3). This action was subsequently transferred to the United States District Court for the Western District of Washington, Northern Division. The defendants answered this complaint (Tr. 24) and on April 11, 1955, filed a third party complaint against United States of America praying for full indemnity against the United States for any recovery that would be had against Orion, *et al.*, by the plaintiff Basnight (Tr. 7). This third party complaint was based upon the Federal Torts Claims Act, the Suits in Admiralty Act and other applicable federal statutes.

On June 15, 1955, the United States of America filed a motion to dismiss the third party complaint on the ground that the court lacked jurisdiction under the Federal Torts Claims Act and the Suits in Admiralty Act, that the venue was improperly laid in the Western District of Washington, that the third party plaintiff did not reside in the district, that the act complained of did not occur in the district, that the cargo sought to be charged was not to be found in said district and that the complaint failed to state a cause of indemnity against the third party defendant (Tr. 12). Argument was had on this motion on September 19, 1955, and an



order denying the motion was entered on October 6, 1955 (Tr. 21). The United States of America then answered the third party complaint (Tr. 22).

At the trial of the cause which commenced on May 23, 1956, it was agreed that the court and not the jury would be the trier of the fact with respect to the claim for recovery over against the United States (Tr. 51, 52). The trial resulted in a verdict for the plaintiff against Orion, *et al.* (Tr. 31), from which the latter appealed to this court on July 17, 1956 (Tr. 33).

Arguments on the recovery over proceedings were had on July 27, 1956 (Tr. 56), as a result of which an order of dismissal without prejudice was entered on the same date (Tr. 34). The defendants and third party plaintiffs moved to vacate this decree of dismissal and for an order transferring the cause to the Southern District of New York (Tr. 36). In an oral opinion rendered from the bench the court denied these motions (Tr. 97). The defendants and third party plaintiffs thereupon, on September 7, 1956, filed notice of appeal to this court from the final judgment in the third party action entered on July 27, 1956, and from the order denying their motions for reconsideration and for the vacation of the decree of dismissal and from the order transferring the cause to New York entered on August 20, 1956 (Tr. 39).

The third party proceedings are reported at pages 56 through 97 of the transcript. The proceedings consisted principally of the beginning of an opening statement by counsel for the third party plaintiffs, extensive colloquy with the court on the Government's var-



ious objections, and an offer of proof made by counsel for the third party plaintiffs at page 92.

The decision of the court to dismiss the third party proceedings appears to be based on a finding that there was not contained within the third party complaint an allegation of the presence of the vessel in the jurisdiction during the pendency of the proceedings.

In order to succinctly present the questions involved and the manner in which they were raised, as required by the rules of this Court, it is deemed advisable to summarize the portion of the transcript referred to above, in chronological order:

1. United States Attorney stipulates that the S.S. SEACORONET was in a port in the jurisdiction of the court during the pendency of the action, said stipulation being subject to an objection on the grounds of irrelevancy and immateriality (Tr. 59, 66).

2. The court holds that the action for recovery over properly lies and that it is a proper suit insofar as venue is concerned (Tr. 75).

3. The court confirms that it has already ruled on the alleged lack of venue under the Suits in Admiralty Act, in favor of third party plaintiff (Tr. 76).

4. The court confirms that it has jurisdiction of the third party action against the United States (Tr. 78).

5. Third party plaintiffs move to amend the third party complaint to conform to proof that vessel was within district during pendency of action (Tr. 82).

6. United States Attorney confirms that his objection to proof of venue was based solely on irrelevancy and immateriality (Tr. 85 and again at Tr. 87).

7. The court sustains the objection of the United States to the trial amendment on venue.

8. The court announces that his ruling is without prejudice to the right of third party plaintiffs to sue United States in the proper district and in the proper venue (Tr. 91).

9. Third party plaintiffs make their offer of proof that the vessel was in the port during the pendency of the action (Tr. 92).

10. The United States' objection to the offer of proof made again on the grounds of irrelevancy and immateriality is sustained (Tr. 93).

11. Third party plaintiffs move under 28 U.S.C.A. §1406(a) that the matter be transferred to the Southern District of New York (Tr. 93).

12. The court states it will deny the motion to transfer (Tr. 95).

13. The court denies subsequent written motion made to transfer under 28 U.S.C.A. §1406(a) (Tr. 98).

From the foregoing it appears that the following questions are involved in this appeal:

1. Did the absence of an allegation of venue in the third party complaint render the same fatally defective.

2. If an allegation of venue in the third party complaint be deemed necessary, did the trial court abuse its discretion in sustaining the objection of the United States to the requested trial amendment.

3. Did the trial court abuse its discretion in refusing the appellant's offer of proof with respect to venue.

4. Did the trial court err in failing to treat the respondent's motion for dismissal as a motion to transfer to a proper venue.

5. Did the trial court abuse its discretion in denying the motion to transfer under the provisions of 28 U.S.C.A. §1406(a).

### **SPECIFICATION OF ASSIGNED ERRORS RELIED UPON**

1. The district court erred in sustaining the objection to the trial amendment requested to make the pleadings conform to the proof with respect to venue.

2. The district court erred in sustaining the objection to the offer of proof concerning venue.

3. The district court erred in denying the motion to transfer the third party action under the provisions of 28 U.S.C.A. §1406(a).

4. The district court erred in dismissing the third party complaint on the ground of lack of venue.

### **ARGUMENT**

#### **I. No Necessity of Alleging Venue Under Suits in Admiralty.**

Without referring to it initially as a requirement either of venue or of jurisdiction, the Suits in Admiralty Act, 46 U.S.C.A. §742 (2), provides in part:

“Such suits shall be brought in the District Court of the United States for the district in which the party so suing, or any of them, reside or have their principal place of business in the United States, or in which the vessel or cargo charged with liability is found. \* \* \* Upon application of either

party the cause may, in the discretion of the court, be transferred to any other District Court of the United States.”

This Act was passed in 1920 and since that time there have been a myriad of trial court and appellate court decisions interpreting the provisions of this Act with particular respect as to whether the above portions of the Act refer to venue or to jurisdiction.

In 1946 Judge Kennedy of the Southern District of New York summarized the leading cases up to that date in *Sawyer v. United States*, 66 F.Supp. 271 (D.C.S.D. N.Y. 1946). Questions which the court sought to answer included whether the above quoted portions of the Suits in Admiralty Act indicated a limitation on jurisdiction over the subject matter or whether it merely defined venue and whether or not, if said provisions were held to concern venue, a respondent would waive an objection thereto by pleading to the merits when the libel itself was silent on the libelant's residence or place of business and on the location of the vessel involved. After reviewing at length some nine cases Judge Kennedy stated (p. 274) :

“I do not attempt to reconcile these cases. I regard them as irreconcilable.”

However, in 1948, this particular question was specifically and directly answered in *Hoiness v. United States*, 335 U.S. 297, 93 L.ed. 16. This was a libel in personam against the United States of America to recover insurance benefits, damages, wages and maintenance. In the report of the lower court proceedings, 75 F. Supp. 289 (D.C.N.D. Cal. 1947), it is stated (p. 291) :

“This libel does not allege that libelant has his

principal place of business within the court's jurisdiction, or that the vessel, at the commencement of the action, was found within this district. It is obvious, therefore, that the libel is fatally defective."

The lower court then dismissed the libel for lack of jurisdiction.

The appeal to the Court of Appeals for the Ninth Circuit, 165 F.(2d) 504 (C.A. 9 1947), was dismissed, as having been taken from a non-appealable order, and an appeal was then taken to the United States Supreme Court.

Mr. Justice Douglas, author of the United States Supreme Court decision on the appeal, noted that in spite of the absence of allegations of residence and of the location of the vessel, the United States had not appeared specially but had answered to the merits. He noted further that the District Court had raised the question of jurisdiction *sua sponte* and had dismissed the libel. The Supreme Court stated:

"II. The ruling of the District Court that the provisions of §2 of the Suits in Admiralty Act, directing where suit shall be brought, were jurisdictional, was in our view erroneous. Those provisions properly construed relate to venue. \* \* \* Congress, by describing the district where the suit was to be brought, was not investing the federal courts 'with a general jurisdiction expressed in terms applicable alike to all of them.' See *Panama R. Co. v. Johnson*, *supra* (264 U.S. 384, 68 L.ed. 751, 44 S.Ct. 391). It was dealing with the convenience of the parties in suing or being sued at the designated places. \* \* \* The residence or principal place of business of the libelant and the place where the



vessel or cargo is found may be the best measure of the convenience of the parties. But if the United States is willing to defend in a different place, we find nothing in the Act to prevent it.

“The judgment is reversed and the case is remanded to the district court for further proceedings in conformity with this opinion.”

Thus it appears that the presence or absence of allegations of residence and vessel location are not jurisdictional and that their absence alone does not justify a judgment of dismissal. Whereas in the *Hoiness* case, *supra*, the Government had not raised objection to the place of the trial (venue) nor had it made a motion to dismiss, in the case at bar the Government made a pre-trial motion to dismiss, alleging among other things the appellant's failure to allege facts showing proper venue both on the grounds of residence and the absence of the cargo sought to be charged.

If the trial court in the *Hoiness* case, *supra*, was in error in dismissing the libel, having raised the jurisdictional question *sua sponte*, so likewise was the trial court in error in the case at bar in dismissing the libel rather than accepting and ruling on the offer of proof of venue.

**II. If the Allegations of Venue Were Essential to the Third Party Complaint, Did the Trial Court Abuse Its Discretion in Sustaining an Objection to the Appellant's Motion to Amend Its Complaint to Conform to the Proof, Since No Prejudice to Respondent Would Have Resulted from the Amendment.**

While the appellant feels that the *Hoiness* case, *supra*, should dispose of all questions on this appeal,

the appellant, however, will now consider its other assignments of error.

The respondent made its original pre-trial motion to dismiss the third party complaint on June 15, 1955, in part upon the ground of failure to allege facts showing proper venue. An order denying this motion was entered on October 6, 1955, reserving to respondent herein leave on the trial of the cause to renew said motion. Thus respondent was forewarned of the possibility that at the trial of the cause the court would again deny its motion to dismiss even though the allegations of venue had not in the interim been added to the third party complaint. Respondent was bound to have knowledge that the appellant would be required to establish venue by presentation of testimony or other evidence at the trial and for the court to have permitted such amendment at the trial would have worked no hardship or surprise upon the respondent since said amendment was merely to conform the pleadings to the proof which at the time of the amendment had been submitted. This proof which was submitted prior to the motion to amend consisted of a stipulation by counsel for respondent that the vessel had entered the district during the pendency of the action (Tr. 59, 66). This stipulation was subject to the respondent's objection on the grounds of irrelevancy and immateriality. No objection was made to this evidence either upon the ground that it concerned matters not contained within the third party complaint, or that the United States would be prejudiced thereby. Furthermore, the granting of this requested amendment was required by the specific pro-

visions of the Federal Rules of Civil Procedure No. 15 (b) readings as follows:

“(b) AMENDMENTS TO CONFORM TO THE EVIDENCE. When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence would prejudice him in maintaining his action or defense upon the merits. The court may grant a continuance to enable the objecting party to meet such evidence.”

What constitutes an “abuse of discretion” is difficult of exact definition, but such abuse would clearly appear to exist in this case, where no harm whatever results to the one party, and where the other party is out of court.

### **III. If Necessary to Allege Facts of Venue, Did the Trial Court Err in Refusing the Appellant's Offer of Proof.**

As part of its case in chief, appellant called to the stand a witness who was prepared to testify that the vessel was within the jurisdiction of the court during

the pendency of the action (Tr. 92). The court directed that an offer of proof be made. The offer of proof established that the vessel had been in the district during the pendency of the action. The respondent objected to this offer on the grounds of irrelevancy and immateriality which objection was sustained (Tr. 93).

The element of venue is, of course, basic in any lawsuit and determines whether the litigant is entitled to continue his case in the particular court in question. The determination of the facts which establish venue are to be found in the pleadings, from the nature and place of the accident, the identity and location of the court, or from any evidence touching upon these facts developed during the trial. That evidence of a fact which would assist in the determination of venue is material, whether said fact is contained in the pleadings or not, is a proposition so fundamental that no cases on the point can be found. Thus it is clear that the Government's objection to the offer on the ground of immateriality should not have been sustained and the trial court erred in so doing.

#### **IV. The District Court Erred in Denying the Appellants' Motion to Transfer.**

Title 28 U.S.C.A. §1406(a) reads as follows:

“The district court of a district in which is filed a case laying venue in the wrong division or district shall dismiss, or if be in the interest of justice, transfer such case to any district or division in which it could have been brought.”

The Suits in Admiralty Act (46 U.S.C.A. §742) under which this third party complaint was brought, states in part as follows:



“Upon application of either party, the cause may, in the discretion of the court, be transferred to any other district court of the United States.”

Appellant, toward the close of its case and following the announced intention of the court to enter an order dismissing the cause, orally made a motion to transfer under §1406(a) (Tr. 93). This motion was denied by the court (Tr. 94). Subsequently on August 3, 1956, the appellant filed a formal motion to vacate the decree of dismissal and for an order transferring the third party cause of action to the Southern District of New York (Tr. 36).

This motion was based upon the ground that such transfer was required “in the interest of justice” since a new action to be filed in the Southern District of New York, as suggested by the court, would have been time barred under a ruling of the Second Circuit which will be referred to below. This motion to vacate, etc., was argued before the trial court on August 20, 1956, and was denied in all respects.

Respondent can think of no better example of a transfer being made “in the interest of justice” than one where, but for such transfer, one of the litigants would be time barred in his claim against the other as is respondent in this case. In *Ryan Stevedoring v. United States of America*, 175 F.(2d) 490 (C.A. 2, 1949), the appellee, United States of America, in a third party claim brought against it under the Suits in Admiralty Act, pleaded the two-year statute of limitation under said Act, 46 U.S.C.A. §745. The third party plaintiff-appellant relied on the usual rule that a claim for indemnity accrues only for the purpose of limitation when



the indemnitee has been subjected to liability. The court reviewed the cases which had applied this general rule to an agent's claim for indemnity against the United States but distinguished those cases as being instances where the duty to indemnify a subordinate was clear, such as under a contract, and stated that they were *not* cases of the addition or substitution of an additional or sole tortfeasor. The court then stated (p. 494):

“An impleading petition against the United States should be dismissed where the bar of the statute obtains.”

Thus it is clear from the foregoing that the Second Circuit, upon the pleading by the United States of the bar of the statute of limitations, would dismiss any subsequent action filed by the appellant herein against the respondent in the Southern District of New York.

The trial court herein upon being advised of this rule of the Second Circuit and that therefore the claim of appellant would be time-barred clearly abused its discretion in overruling the appellants' motion to transfer.

In two subsequent district court decisions, it was pointed out that a transfer was the proper procedure under circumstances similar to those at bar. In *Falciani v. United States*, 87 F.Supp. 482 (D.C.E.D. Penn. 1949) Judge McGranery, in another Suit in Admiralty claim for personal injuries, stated as follows (p. 483):

“This is an action by a seaman, under the Suits in Admiralty Act, 46 U.S.C.A. §741, et seq., to recover for injuries sustained by him while he was a member of the crew of respondent's vessel. Two

years after filing its answer, respondent moves to dismiss the libel on the ground of improper venue. Inasmuch as the ground assigned does not relate to jurisdiction, *Hoiness v. United States*, 335 U.S. 297, 69 S.Ct. 70, the respondent concedes that his motion to dismiss must be treated as a motion to transfer. 28 U.S.C.A. §1406.”

The case of *Squires v. The Ionian Leader*, 100 F. Supp. 829 (U.S.D.C. N.J. 1951), is one of the few cases in which the United States was involved as a third party defendant as in the case at bar. The United States was impleaded in the case under the Suits In Admiralty Act following which the Government filed exceptions claiming that the petitioner was not a resident and that the vessel in question was not within the district. The court stated (p. 837):

“The objection is actually an objection to the ‘venue’ of the suit and not to the ‘jurisdiction’ of the court. The Act expressly provides that ‘\* \* \* \*’ It is our opinion that the jurisdictional requirements of the statute are present but that the venue of the suit is improperly laid. The petitioner does not maintain an office in this district and there is no evidence that the *The Farallon* was in this district at the time of the filing of the petition or at any time prior thereto.

“The objection to the venue of this suit must be sustained for the reason stated. It is our opinion, however, that the impleading petition should not be dismissed but that the case should be transferred to one of the two districts in which it could have been brought. 28 U.S.C.A. §1406 (a). We shall entertain a motion to transfer the case to a district convenient to the litigants.”

An application by the Second Circuit of the transfer provisions of §1406 (a) is to be found in *Orr v. United States*, 174 F.(2d) 577 (CA 2 1949). This was a Suits in Admiralty claim against the United States for personal injuries suffered by the libelant. An objection was raised by the United States to the venue and it was established on the trial that the elements of residence and the presence of the vessel were not present in the case. The lower court thereupon dismissed the suit. The Second Circuit stated (p. 579) :

“The libelant would lose a right of any substance only if the suit was dismissed (as it was here by the court below) and his claim in the meantime had become barred by the two-year statute of limitations. But §1406 of Title 28 U.S.C.A. preserves the suit by providing that: (citing 1406 (a)).”

The decree dismissing the libel was reversed and the cause was remanded to the District Court with directions to transfer the suit to a proper district pursuant to the above statute.

On a petition for rehearing the problem of the retroactive application of §1406(a) was raised. In deciding that this section could operate retroactively the court stated :

“The Revisor’s Note to §1406(a) says that that section ‘provides statutory sanction for transfer instead of dismissal, where venue is improperly laid.’ This comment on the scope of §1406(a) seems to point directly to the elimination of the bar of the statute of limitations in cases where jurisdiction exists and there is nothing to prevent its exercise but the lack of proper venue. Moreover, §1406 (a) on its face is applicable to the ‘district court

of a district in which is filed a case laying venue in the wrong division or district.' The case at bar is just such a case and §1406(a), which went into effect September 1, 1948, must be applied retroactively to a pending litigation where no valid judgment has been rendered prior to that date."

The case of *Untersinger v. U. S. A.*, 172 F.(2d) 298, 181 F.(2d) 953 (C.A. 2, 1949, 1950), not only treats the problem of transfer under §1406(a) but provides a logical answer to the problem herein raised as to whether or not it was initially necessary for the appellant to allege the facts of venue. The trial court found that the libelant under the Suits in Admiralty Act was not a resident of the district and that the merchant ship was not within the jurisdiction of the court. The libel was dismissed (75 F.Supp. 155). On appeal to the Second Circuit (172 F.(2d) 298) the court stated that the libel had contained no allegation as to residence or as to the whereabouts of the vessel. The court, referring to the *Hoiness* case, *supra*, held that these elements were referable to venue and were not jurisdictional. The court further decided that the contents of the answer filed by the United States had negatived its willingness to proceed, reserving its objections to venue, and that therefore there was no waiver. The court thereupon affirmed the decree of dismissal and stated as follows (p. 301):

"Accordingly the decree is affirmed, but with leave granted to the libelant, if he so desires, to apply within 30 days to the district court, under §1404 of Title 28 U.S.C.A., 1948 Revision, to transfer the action to any other district where it might have been brought. Whether that action is applicable to the present cause and whether the action



should be transferred are questions for the district court upon which we intimate no opinion.”

Accordingly the lower court vacated the dismissal and ordered the suit to be transferred (87 F.Supp. 532). This order was thereupon appealed again to the Second Circuit. In affirming this order of transfer the court stated (181 F.(2d) 953, 956) :

“Hence, §1406(a), as amended in 1949, gave power to the district court to vacate the dismissal and transfer the suit. The United States does not challenge the propriety of the transfer as matter of discretion; and it is difficult to see how anyone could do so. However, in what we have said, we do not mean to be understood as deciding more than that Judge Knox had jurisdiction to enter the order on appeal, if he thought that course to be ‘in the interest of justice.’ ”

The Second Circuit in *Warren v. United States*, 179 F.(2d) 919 (C.A. 2, 1949), made the following comment on the curing of a defect in venue (p. 920) :

“The libel against the United States was dismissed for improper venue. The libelant was not a resident of the Southern District of New York and when the libel was filed the vessel on which he had been employed was not within that district. Section 2 of the Suits in Admiralty Act, 46 U.S.C.A. 742, prescribes the venue for suits of this character. *Hoiness v. United States*, 335 U.S. 297, 69 S.Ct. 70. Plainly venue was lacking when the libel was filed, and the answer of United States pleaded this as a defense. At the trial, however, it was stipulated that the vessel was within the Southern District of New York during the pendency of the action. The libelant contends that this cured any defect of venue. We think he is right.”



The libel in *Preussler v. United States*, 102 F.Supp. 274 (U.S.D.C. S.D.N.Y. 1952) in a Suits in Admiralty Act action contained no allegation that the vessel would be within the district. In spite of this the court held that this defect in venue would be cured if the vessel came into the district during the pendency of the action. The court, however, following the argument of the respondent and the evidence that the possibility that the vessel would come into the port was very slight, held that this mere possibility did not support the venue. It is to be noted, however, that "in the interest of justice" the action was ordered transferred to the proper district in Florida where the libelant was a resident.

The Second Circuit in *Gill v. United States*, 184 F. (2d) 49 (C.A. 2, 1950), again ruled that the presence of the vessel during the pendency of the action corrected any defect in venue. The following comment by Judge Chase is of particular interest (p. 51):

"Accordingly, we do not find it necessary to decide whether, as the trial court held, the failure to press the point as to the alleged improper venue before beginning the trial on the merits taken together with the filing of the petition impleading the stevedoring company and the other circumstances here shown add up to waiver of defense based upon defective venue. We do wish to point out, however, the desirability of having such questions brought on for determination promptly and preferably in suitable pre-trial proceedings. By so doing effective and proper use may be made of 28 U.S.C.A. §1406(a)."

The latter comment points out precisely the harm and delay which has now occurred in the case at bar as a result of the action of the trial court, some eight

months before trial, in denying the respondent's motion to dismiss upon grounds of venue but in reserving to the respondent a right to renew the same motion at the time of trial. As handled in the *Squires* and *Falciani* cases, *supra*, the court should have treated the motion to dismiss as one for a change of venue if the appellant could not have established proper venue at the time of said argument. The third party proceedings could then have been held in the proper district following the termination of the main cause of action by the plaintiff against the appellant.

A Suits in Admiralty action against the United States was dismissed in *Podgorski v. United States*, 87 F.Supp. 731 (U.S.D.C. E. D. Penn. 1949), when the court determined from the admissions of the libelant on the argument of the motion to dismiss that venue did not lie either in terms of residence or the presence of the vessel. The court concluded that the Government had not waived its rights under the venue provisions and in the absence of appropriate compliance therewith by the libelant the libel was dismissed. The opinion reflects, however, that there were no allegations in the libel concerning the venue provisions but that the dismissal was based not on the absence of the allegations thereon but on the failure of proof thereof.

#### **V. The District Court Erred in Dismissing the Third Party Complaint on the Ground of Lack of Venue.**

In the foregoing the appellant has set forth authorities indicating that the trial court erred in rejecting the offer of proof on venue and in failing to permit a trial amendment alleging the proper venue.

An additional ground which was urged upon the court and which should have justified a finding of proper venue is that of the theory of ancillary jurisdiction and venue. A third party complaint is not an independent and original action. It is an ancillary proceeding incidental to the main action. The Tenth Circuit has so stated in *United States v. Acord*, 209 F.(2d) 709 (cert. den. 98 L.ed. 1115) as follows:

“It has been held that a proceeding on a third party plaintiff’s claim under Rule 14 is an ancillary proceeding incidental to the main action and that no separate ground of jurisdiction is required.”

As authority for the foregoing the court in a footnote cited cases from the Second and Tenth Circuits and from 14 District Courts.

In this same case, Chief Judge Phillips stated that jurisdiction of the ancillary proceeding is dependent on the jurisdiction of the court over the principal proceeding. He then proceeded to discuss the similar problem with reference to venue and concluded as follows (p. 714):

“(6) While the question is not free from doubt, we are of the opinion that the reasons which give the court jurisdiction over an ancillary proceeding by virtue of its jurisdiction over the principal action, likewise support the conclusion that venue in the ancillary proceeding may depend or rest upon the venue in the main proceeding.

“(7) Venue provisions are for the convenience of the parties. The granting or denial of leave of a defendant to prosecute a third-party proceeding under Rule 14 rests in the sound discretion of the trial court, and where an action on the third-party

claim could not be maintained as an original proceeding because of lack of proper venue, the court should deny leave to bring a third-party proceeding under Rule 14, if it will result in great inconvenience to the third-party defendant.

“(8) Here, the United States suffered no disadvantage or inconvenience by being required to defend the action in the western, rather than in the eastern district of Oklahoma.

“We conclude that the plea of improper venue was properly denied.”

At no point in the third party proceedings and the arguments thereon did the respondent claim disadvantage, inconvenience of witnesses or prejudice with respect to the claim of improper venue.

## CONCLUSION

It is respectfully submitted that under the authorities hereinabove presented, the trial court should have decided as follows:

### I. On Venue

1. It should have ruled that an allegation of venue was unnecessary, that venue had been proven, and it should have decided the third party claim on the merits.

2. If it felt that an allegation of venue was necessary it should have granted the appellant's motion to amend and it should then have concluded that venue had been established by the evidence.

3. It should have accepted the appellant's proof on venue, whether there was an allegation of venue in the third party complaint or not, and from the offer of proof should have concluded that proper venue existed.

## II. On the Motion to Transfer

1. If the court found that venue had not been established it should have treated the Government's motion to dismiss as one to transfer the cause and should have granted such transfer.

*or*

2. The court should have granted the appellant's motion to transfer made at the close of the third party proceedings.

*or*

3. The court should have granted the appellant's motion to vacate the order of dismissal and to transfer the cause to the Southern District of New York.

Respectfully submitted,

BOGLE, BOGLE & GATES

ROBERT V. HOLLAND

*Attorneys for Appellants.*



No. 15,264

IN THE

United States Court of Appeals  
For the Ninth Circuit

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ORION SHIPPING AND TRADING COM-  
PANY, INC., a corporation, and PA-  
CIFIC CARGO CARRIERS CORPORATION,  
*Appellants,*

VS.

UNITED STATES OF AMERICA,  
*Appellee.*

---

On Appeal from the United States District Court  
for the Western District of Washington,  
Northern Division.

BRIEF FOR APPELLEE.

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No. 15,264

IN THE

**United States Court of Appeals  
For the Ninth Circuit**

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ORION SHIPPING AND TRADING COM-  
PANY, INC., a corporation, and PA-  
CIFIC CARGO CARRIERS CORPORATION,  
*Appellants,*

VS.

UNITED STATES OF AMERICA,  
*Appellee.*

**On Appeal from the United States District Court  
for the Western District of Washington,  
Northern Division.**

**BRIEF FOR APPELLEE.**

---

**JURISDICTION.**

The District Court had no jurisdiction of this action, which was commenced by the filing of a third party complaint (R. 7) against the United States at law, since the claim arises out of the carriage of cargo owned by the United States upon a vessel operated as a merchant vessel by a corporation having its corporate residence in New York City and therefore lies exclusively within the admiralty jurisdiction of the

cargo of scrap metal being loaded, and failing to prevent escape of the gas.

The United States moved (R. 12) to dismiss the third party complaint on grounds of lack of jurisdiction at law, improper venue and failure to allege facts showing proper venue, as well as other grounds. The Government's motion to dismiss, when first argued, was denied with leave to renew it at the time of trial (R. 21). After trial resulting in a judgment (R. 31) for plaintiff against Appellants here, the court below granted the Government's motion and dismissed the third party complaint as exclusively cognizable under the Suits in Admiralty Act (R. 34). Appellants subsequently moved for reconsideration (R. 35) and for transfer of the third party complaint to the Southern District of New York (R. 36) and both those motions were denied (R. 38). From the lower court's dismissal of the third party complaint and refusal to transfer it, Appellants are now appealing.

This case is one of seven cases at law filed by as many different plaintiffs against defendants-appellants. In each separate case, as here, a third party complaint against the United States was filed, in each case the third party complaint was dismissed, and in each case an appeal was taken. In order to shorten the record the parties have stipulated and the court has ordered (R. 99-102) that the cases be consolidated for appeal and that the result in the present case, No. 15,264, be the law of the case in each of the other consolidated cases. Certain matters from the record of another of the consolidated cases, No. 15,261, have

been included in the printed record and will be referred to.

Attorneys for Appellants correctly state in their brief (p. 7) that as early as June 15, 1955, the United States moved to dismiss the third party complaint in this case and, while they recite certain of the grounds of the motion (lack of jurisdiction, actual improper venue and failure to state a cause of action), they omit to state a ground which, under their argument of the case, is of considerable significance, that is, "That third party plaintiff has failed to allege facts showing that the venue is properly laid in the Western District of Washington" (R. 13). Counsel further state that the motion was denied (Brief 8) but neglect to point out that the denial was with explicit leave to renew the motion at the time of trial (R. 21). At the opening of trial the motion was renewed (R. 49) and the grounds of the motion were continually reserved (R. 49, 53-54, 57, 59, 67).

Actually, as early as December 6, 1954, in the companion case, No. 15,261, now consolidated with this case on appeal, Judge Lindberg granted the Government's motion and dismissed the third party complaint. (R. 6.) A motion to vacate the dismissal was subsequently granted, without opposition from the Government, in order that the case could be transferred to Judge Bowen before whom the other six law cases were then pending. (See docket entries, R. 42-43). Despite this early warning to Appellants and despite the fact that the issues of jurisdiction and venue were pointedly left open for later decision by



Judge Bowen, the Appellants did not file the appropriate libel in New York until July 26, 1956, when they filed the action, in which the amended libel, seeking indemnity for the judgment in this present action and the other actions consolidated with it on appeal here, is exhibited in Appendix B. It is an astonishing feature of this case that it is one of no less than 12 separate cases filed against the United States by appellants on only one cause of action<sup>1</sup> and that Appellants have accomplished this feat mainly by the improper use of third party procedure which was intended to reduce rather than multiply litigation.

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### SUMMARY OF ARGUMENT.

I. This case arises from the attempt of shipowners carrying Government cargo to sue the United States, in clear violation of the terms of consent to be sued in the Suits in Admiralty Act, by third party complaints at law in a number of separate suits by seamen for injuries arising out of the Government's loading of its cargo. Instead of filing in the proper district court the single suit in admiralty provided in the Suits in Admiralty Act for all the damage they might claim as the result of various seamen's actions against them in different courts, they have attempted to use third party complaints at law not only to circumvent the exclusive jurisdiction of the Suits in Admiralty Act but to violate the very purpose of third party proceedings by involving the Government

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<sup>1</sup>See R. 99, Footnote 9 *infra* and Appendices B and F.

in a needless multiplicity of actions arising out of, at the most, one single cause of action.

The application of the Suits in Admiralty Act to appellants' claims is clear from the Act and is undisputed by the parties. The Supreme Court has always held that where the remedy of a suit in admiralty under the Act is available it is the exclusive remedy against the United States, and has likewise held that the remedy provided by the Suits in Admiralty Act may not be pursued in a suit at law, but only in admiralty, and according to its procedures and rules.

Under the express terms of the Federal Rules of Civil Procedure, Rule 14, providing for third party complaints, does not apply to admiralty suits and, moreover, may not be used to extend the jurisdiction of the court or change the venue of an action. Similarly, Admiralty Rule 56 has no application to a case brought at law and governed by the Federal Rules of Civil Procedure. There is not even the authority of a rule, therefore, for the use of a third party complaint in this case. More serious, however, since rules do not confer jurisdiction, are the many and repeated holdings of the courts, on jurisdictional grounds, that third party practice may not be used to mingle in one case admiralty claims and common law claims, where the court as then sitting would be without jurisdiction of one of the claims if it were brought in a separate suit. The doctrine of ancillary jurisdiction, seemingly relied upon by appellants, applies only to suits where it is made necessary by the court's custody of property or assets which are the subject of the

various claims. Since the present case involves no property or assets in the custody of the court, the doctrine of ancillary jurisdiction has, of course, no application here.

II. Not only did Appellants ignore the jurisdictional commands of the Suits in Admiralty Act, but they also ignored its requirement, as applied to this claim, that the suit be brought in the district of their corporate residence, which the record shows to be in New York. This venue requirement has at no time been waived by the Government and is one of the strict conditions of the permission to sue under the Act. Actually, Appellants' confusing contentions about the presence of the vessel at Seattle are completely irrelevant, since the action is not *in rem* or on *in rem* principles and since the vessel was Appellants' own and Appellants in their claim against the Government are therefore, of course, not charging any liability on the vessel.

III. Finally, Appellants' motion to transfer the third party proceedings to the Southern District of New York was properly denied for a number of reasons. First, the court could not transfer since it had no jurisdiction to do anything but dismiss. Second, the transfer of third party proceedings in any case would be improper, as contrary to the purpose of the procedure by using it to make two cases instead of one and to put the third party defendant through trial in both, and by raising insuperable problems concerning appeals from the different portions of the case. Third, the authorities in the district and circuit to

which transfer was asked show that transfer would not have been accepted there. Lastly, if the court below had had any discretion to transfer, denial would have been a proper exercise of that discretion since Appellants had stubbornly persisted in their vexatious course of multiple suits despite early and continued objections and with the knowledge that the jurisdiction of this action remained to be decided at trial.

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## ARGUMENT.

### I.

**THE DISTRICT COURT LACKED JURISDICTION OF THE THIRD PARTY COMPLAINT AT LAW AND PROPERLY DISMISSED IT.**

**A. Third party plaintiffs' claim is exclusively under the Suits in Admiralty Act.**

Although it appears that Appellants now agree that the Suits in Admiralty Act applies to their claim, the Court is entitled to have this conclusion explained since, of course, jurisdictional matters are never settled by consent.

Where, as here, the vessel is a merchant vessel and the claim is based upon carriage of cargo owned or possessed by the United States, the claim is within the terms of the Suits in Admiralty Act. It has long been established by the Supreme Court that, as to such claims, "arising out of the operation of merchant vessels," the admiralty remedy under the Suits in Admiralty Act is exclusive of any other remedy. *Johnson v. Fleet Corporation*, 280 U. S. 320, 326, 1930 A. M. C. 1, 5. If a libelant entertains any doubt as



to the sufficiency of Suits in Admiralty Act jurisdiction, he can always protect himself by also invoking in his libel the jurisdictional grants of the Tucker and Tort Claims Acts, 28 U. S. C. 1346 (a) (2) and 1346 (b). These provisions are applicable to "any civil action," which is held to include proceedings in admiralty. See *Torres v. Walsh*, 221 F. 2d 319, 321, 1955 A.M.C. 1181, 1184 (2nd Cir.) collecting cases.

The third party complaint in this case (R. 7-12) alleges, in Paragraph IV, that the SS SEACORONET was operated as a merchant vessel carrying Government cargo, and in Paragraphs VI and VII, that the injuries of plaintiff Basnight arose out of acts of the United States in connection with the loading of such Government cargo aboard the SEACORONET. It is plain, therefore, from the third party complaint itself, that the cargo was owned or possessed by the United States, that the vessel was operated as a merchant vessel and that the claim arose from alleged breach of the Government's duty in its relationship to Appellants as cargo owner and shipper on their vessel.

The claim in this case is unquestionably embraced by the plain language of the Suits in Admiralty Act at 46 U. S. C. §742, which provides in pertinent part that:

"In cases where . . . if such cargo [owned or possessed by the United States] were privately owned and possessed, a proceeding in admiralty could be maintained at the time of the commencement of the action herein provided for, a libel in



personam may be brought against the United States . . .” (Material in brackets supplied from §741).

In the present case it is undisputed that the cargo was owned or possessed by the United States and that if it were privately owned and possessed, that is, if the United States were a private party, a proceeding in admiralty could be maintained at the time the present action was commenced. Appellants were therefore plainly entitled to file a libel *in personam*, as they have now in fact done (Appendix B) in the Southern District of New York, under the exclusive jurisdiction of the Suits in Admiralty Act.

**B. Admiralty is the exclusive forum for an action under the Suits in Admiralty Act.**

The Suits in Admiralty Act provides only for a libel *in personam* in admiralty against the United States (46 U. S. C. §742). The court below, sitting as a court of law, under the Federal Rules of Civil Procedure rather than the Admiralty Rules, had no jurisdiction of this action against the United States cognizable under the Suits in Admiralty Act and therefore had no course but to dismiss it. *Johnson v. Fleet Corporation*, 280 U. S. 320, 1930 A. M. C. 1. In the recent case of *Dell v. American Export Lines v. United States*, 142 F. Supp. 511, 1956 A. M. C. 1567 (S. D. N. Y.), an action of the precise character of the present one where the court also dismissed the third party complaint at law for lack of jurisdiction, the *Johnson* case is carefully reviewed and applied to

the improper attempt to proceed by third party complaint at law.

This Court, in a recent case, in construing the Death on the High Seas Act, 46 U. S. C. §§761 *et seq.*, has reaffirmed that when a statute, as in this case, grants jurisdiction in admiralty, such jurisdiction may not be exercised by a court sitting at law. *Higa v. Transocean Air Lines*, 230 F. 2d 780, 1956 A. M. C. 122 (9th Cir., 1955). The same conclusion was reached under the Admiralty Extension Act, 46 U. S. C. §741, in *Dept. of Highways v. United States*, 204 F. 2d 630, 1953 A. M. C. 2131 (5th Cir.). As Judge Mathes said in *Kunkel v. United States*, 140 F. Supp. 591, 595, 1956 A. M. C. 1195, 1200 (S. D. Cal.), “. . . the inherent and fundamental difference between actions at law and suits in admiralty can never be ignored; and no legislative fiat or judicial indecision can wipe the distinction out.”

Any attempt to confuse admiralty and law or substitute the one for the other runs into substantial differences in the practice and procedure to which the parties are entitled under the law. Proceedings at law, like the present one, are governed exclusively by the Federal Rules of Civil Procedure. Rule 81(a) (1) is explicit that the Civil Rules do not apply to an admiralty action. Courts of admiralty, on the other hand, have their own procedure distinct from that at common law. *The Wanata*, 95 U. S. 600 (1877); *Atlee v. Packet Company*, 21 Wall. 389, (1875). That procedure, founded upon the proceedings in civil and ecclesiastical courts as modified by the Supreme

Court's Rules of Practice in Admiralty and Maritime Cases and the rules of local admiralty courts, has entirely different roots and very different features from procedure at law.<sup>2</sup> The Admiralty Rules, of course, have no application to an action at law. *City of Gretna v. Defense Plant Corp.*, 159 F. 2d 412, 1947 A. M. C. 461 (5th Cir.). And just as the litigant at law has a right to have proceedings under the Civil Rules, so the litigant in admiralty has a right to the procedure of the admiralty. See *Jordine v. Walling*, 185 F. 2d 662, 1951 A.M.C. 43 (3rd Cir., 1950).

**C. The exclusiveness of the admiralty remedy under the Suits in Admiralty Act may not be circumvented by the device of third party action.**

The attempt of Appellants in this case to bring an exclusively admiralty action at law and thus thwart the conditions of the Suits in Admiralty Act at the same time they rely upon it, by filing a third party complaint at law, is without the sanction of any statute or rule whatever. The best that can be said for this procedure is that it is apparently intended to obscure the real nature of the action. It is in fact purely and simply an attempt to sue the United States without its consent.

Appellants' brief, by its single-minded discussion of venue matters, would give the impression that only venue questions were involved in this case. But no matter what ground was assigned for dismissal by the

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<sup>2</sup>The foundations and distinctive character of the admiralty procedure have been reviewed by Judge Fee in *Dowling v. Isthmian Steamship Corp.*, 184 F.2d 758, 1950 A.M.C. 1876 (3rd Cir.) cert. denied 340 U.S. 935.

court below, the question of jurisdiction is always the first and most important question in a federal court. Actually, it is clear from the language of Chief Judge Bowen in his oral opinion (R. 97) that he understood that the court lacked jurisdiction of the third party complaint and that the dismissal must stand upon that ground.<sup>3</sup>

The astonishing thing is that Appellants' attorneys, who are experienced admiralty counsel, should attempt this mode of proceeding, without any sanction in statute or rule and in the face of so much authority that it may not be done. Over the years there have been many attempts to blend admiralty and law by the device of joinder, counterclaim, set-off, intervention, and impleader, but no matter what the device, the admiralty and common law jurisdiction of the

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<sup>3</sup>If further evidence were needed of the lower court's views on jurisdiction, it was supplied in the unreported case of *Ostrom v. Weyerhaeuser Steamship Co.*, W.D. Wash., Civil No. 4255 (Feb. 20, 1957), in which copies of the proposed third party complaint and the court's order denying leave to file it are set forth in Appendix C. In that case the same attorneys who represent Appellants here attempted to file a case under the Public Vessels Act and Suits in Admiralty Act by a third party complaint at law. Chief Judge Bowen denied them leave to do so, saying in his order:

"... if the defendant and proposed third party plaintiff had sought to initiate the cause of action alleged by it in its proposed third party complaint independently in this district against the United States of America, the Court would have no jurisdiction over the United States of America and over the objections of the United States of America would be unable to compel the United States of America to submit to the Court's jurisdiction; and ... if it would have no jurisdiction to compel the United States of America to respond to a direct action of the type which the defendant and proposed third party plaintiff attempts to assert here, it likewise is without jurisdiction or power to compel the United States to submit to this Court's jurisdiction under the impleader provisions of Rule 14 of the Federal Rules of Civil Procedure ..."



District Court may not be blended, and actions in admiralty and at law may not be tried in one suit. The Supreme Court so held in *The Sarah*, 8 Wheat. 391, 394 (1823), saying:

“... Although the two jurisdictions are vested in the same tribunal, they are as distinct from each other as if they were vested in different tribunals, and can [not] be blended. . . .”

The lower courts have followed this rule, pointing out in some instances the difficulties of procedure that would arise from confusion of admiralty with law. *United Transp. & L. Co. v. New York & Baltimore T. Line*, 185 Fed. 386 (2nd Cir., 1911); *Kaufman v. John Block & Co.*, 60 F. Supp. 992, 1945 A. M. C. 343 (S. D. N. Y.); *Moyer v. M & J Tracy, Inc.* 1949 A. M. C. 279 (S. D. N. Y., 1948) (not otherwise reported); *McDonald v. Cape Cod Trawling Corp.*, 71 F. Supp. 888, 892, 1947 A. M. C. 699, 705 (D. Mass.)

(“... But I know of no basis for such a hybrid combination of admiralty and law . . . such an innovation . . . might prejudice the parties . . .”); *Eggleston v. Republic Steel Corp. et al.*, 47 F. Supp. 658, 659 (W. D. N. Y., 1942) (“... The remedy of the libellant as against the respondent, Republic Steel Company, is through an action at common law. This specifically is an action in admiralty. The two actions cannot be joined.”)

There have been many attempts to circumvent this rule by the very device of third party procedure which Appellants have tried here. The courts have re-



peatedly held it to be improper and refused to permit it. *Yone Suzuki Co. v. Argentine Ry., Ltd.*, 27 F. 2d 795, 1928 A. M. C. 1521 (2nd Cir.) cert. den. 278 U. S. 652; *Aktieselskabet Fido v. Lloyd Brasileiro*, 283 Fed. 62 (2nd Cir., 1922) cert. den. 260 U. S. 737; *The Bear*, 126 F. Supp. 529, 1955 A. M. C. 1123 (D. Alaska); *Rudy-Patrick Seed Co. v. Kokusai*, 1 F. Supp. 266, 1932 A. M. C. 1508 (S. D. N. Y.); *The Goyaz*, 281 Fed. 259 (S. D. N. Y., 1922) aff'd 3 F. 2d 553, cert. den. 267 U. S. 594; *Reichart Towing Line v. Long Island Machine & Marine Const. Co.* 287 Fed. 269 (E. D. N. Y., 1922); see *Soderberg v. Atlantic Lighterage Corp.*, 19 F. 2d 286, 1927 A. M. C. 907 (2nd Cir.) cert. den. 275 U. S. 542.

As the Court said in the *Aktieselskabet Fido* case, *supra*, at page 74:

“ . . . Now a cause of action which is within the sole jurisdiction of a court of common law cannot be converted into one within the jurisdiction of a court of equity or of a court of admiralty by a mere rule of practice, for it works a change in the substantive law. . . . Of course, there would be constitutional objection, and there are constitutional objections which stand in the way of bringing a common-law action into the admiralty court through the fifty-ninth or the fifty-sixth rule.”

And as the Supreme Court has said in *Armour & Co. v. Fort Morgan Steamship Co.*, 270 U. S. 253, 1926 A. M. C. 327, at footnote 1:

“ . . . The application of Admiralty Rule 56 is limited by similar considerations of jurisdiction

[citing *The Goyaz*, and the *Aktieselskabet Fido*, and *Reichart* cases, *supra*].”

More recent attempts to proceed by third party complaint at law on exclusively admiralty claims against the United States have been repelled by the courts in *Dell v. American Export Lines v. United States*, 142 F. Supp. 511, 1956 A. M. C. 1567 (S. D. N. Y.); *Ostrom v. Weyerhaeuser Steamship Co.*, *supra*; *Durant v. Coastwise Line v. United States*, S. D. Cal., Civil No. 19544 (Jan. 28, 1957) (unreported, Appendix D); and *Mangone v. Moore-McCormack Lines v. American Stevedores and United States*, E. D. N. Y., Civil No. 15951 (Mar. 12, 1957) (not yet reported, Appendix E); see *Cornell Steamboat Co. v. United States*, 138 F. Supp. 16, 20, 1956 A. M. C. 1132, 1143 (S. D. N. Y.).

In the *Mangone* case, in a well-reasoned opinion not yet reported, which is printed as Appendix E to this brief, Judge Bruchhausen of the Eastern District of New York held that the claim, being exclusively under the Suits in Admiralty Act, could not be prosecuted at law by third party complaint. In so holding, Judge Bruchhausen not only recognized the barriers of jurisdiction but reviewed the difficulty, or rather impossibility, of the court's trying to sit at one and the same time under two sets of rules and two different modes of practice, saying in part:

“Since the admiralty court would have jurisdiction, and since jurisdiction would be excluded on the civil side, the question remains whether the Federal Court can try the civil and admiralty

actions together, or more particularly, whether the Court can at the same time sit as a court of law and a court of admiralty.”

\* \* \*

“It has been held that a third party libel under the 56th Rule must be maritime in nature [citations]. It seems conversely that a third party complaint, under Rule 14 of the Federal Rules of Civil Procedure, should be civil in nature. In fact, Rule 81(a)(1) of the Federal Rules expressly provides that said rules do not apply in admiralty.

“While there are some decisions permitting a joinder of jury and non-jury causes, the difficulties encountered therein are minimal by comparison to those in the case at bar. To combine these two jurisdictions together in one litigation seems improper and not feasible.

“Under Civil Rule 14 a party may not be impleaded simply because it is or may be liable to the plaintiff, but only, since the 1946 amendment, upon the ground that it is liable to the impleading defendant; under Admiralty Rule 56 a party may be impleaded upon either ground. [citation]

“Under Civil Rule 14, the Government would not be liable unless the third party defendant satisfied the original judgment [citations]. Under Admiralty Rule 56 libelant is entitled to recover directly against an impleaded respondent for damages caused by the latter’s negligence. When a person or vessel is impleaded under this rule, the case is treated as if the libel had originally been filed against it, and the decree may so provide. [citations]

“The District Court must also consider whether the claim against the Government is maintained in rem or in personam, both of which are permitted by the Suits in Admiralty Act. [citation]

“Variations in pre-trial procedure and evidence greatly augment the difficulties. A recent decision of the Court of Appeals of this Circuit in *Paduono v. Yamashita Kison Kabushiki Zaiaba*, 2 Cir., 221 F. 2d 615, demonstrates, quite clearly, the basic and historical differences between the civil and admiralty jurisdictions. To allow the admiralty jurisdiction, which is constitutional, to be so adulterated by civil diversity jurisdiction, which has come under severe criticism, would impair the usefulness of that ancient and historic tribunal. [citation].”

The difficulty about procedure in this case is manifest from the outset. Defendant must show some authority to implead the United States. But Civil Rule 14 does not apply to an action in admiralty, not only because such a rule cannot work a jurisdictional change, but by virtue of the express provision of Civil Rule 81(a) (1). On the other hand, Admiralty Rule 56 has no application to an action at law. Nor can the two rules be taken together in some vague manner to produce the result which neither can achieve alone, since the rights of the parties differ under the two rules and it is absolutely essential to know under which rule the case is proceeding. When the attempt is made, as here, to blend an admiralty proceeding with a proceeding at law, the result is that there is no set of rules and no procedure, either that of the admiralty



or that of the law, applicable to the entire proceeding and to all the parties.

Appellants rely upon the cases of *Skupski v. Western Navigation Co.*, 113 F. Supp. 726, 1953 A. M. C. 1441 (S. D. N. Y.) and *Canale v. American Export Lines*, 17 F. R. D. 269, 1956 A. M. C. 1344, 1350 (S. D. N. Y., 1955). In neither the *Skupski* nor the *Canale* case did the judge come to grips with the jurisdictional problem under the controlling authorities established by the Court of Appeals for his own circuit, nor with the problems of procedure presented by the attempt to mingle the jurisdictions. In evaluating the *Skupski* and *Canale* cases, it is most significant that in neither case was the Government ultimately required to pay a judgment<sup>4</sup> and that the opportunity was therefore not presented to appeal the rulings to the Court of Appeals and secure their reversal under the rule expressed by that court in the cases already cited above.<sup>5</sup>

The *Skupski* and *Canale* cases have not only been considered and rejected by Judge Bruchhausen in the *Mangone* case, but have been rejected and not since followed in their own district, the Southern District of New York. Judge Dimock of that district said in *Cornell Steamboat Co. v. United States*, 138 F. Supp. 16, 20, 1956 A. M. C. 1132, 1143:

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<sup>4</sup>In the *Canale* case the final disposition by dismissal appears at 1956 A.M.C. 1350.

<sup>5</sup>*Yone Suzuki Co. v. Argentine Ry., Ltd.*, 27 F.2d 795, 1928 A.M.C. 1521 (2nd Cir.); *Aktieselskabet Fido v. Lloyd Brasileiro*, 283 Fed. 62 (2nd Cir., 1922).



“ . . . While *Skupski v. Western Nav. Corp.* . . . permitted joinder of an admiralty claim with a law claim, there seems to be overwhelming authority against such consolidation. . . .”

And more recently, in *Dell v. American Export Lines v. United States*, 142 F. Supp. 511, 1956 A. M. C. 1567 (S. D. N. Y.) the court reviewed the jurisdictional difficulties with particular reference to the fact that the attempt to proceed by third party complaint at law was an attempt to sue the United States without its consent and concluded that the court did not have jurisdiction even to transfer the third party complaint to the admiralty side of court with the rest of the case, but could only dismiss.

A recent decision of this Court, although concerned with a counterclaim against the United States under Civil Rule 13, rather than a third party complaint under Civil Rule 14, is absolutely determinative of the present contention that the Rules may be made the basis for jurisdiction against the United States outside the terms of the statute. In *United States v. Finn*, 239 F. 2d 679 (9th Cir., 1956), this Court held that, particularly in view of Civil Rule 82, Civil Rule 13 could not be made the basis of a counterclaim against the United States for which no statutory authority could be shown. The principles of that decision are as applicable to this attempt under Civil Rule 14 as to that one under Civil Rule 13.

D. The court having no assets or property in its possession, the doctrine of ancillary jurisdiction has no application.

Faced with overwhelming authority that the court lacks jurisdiction at law of the third party complaint based upon the Suits in Admiralty Act, Appellants fall back upon the specious contention that there is "ancillary jurisdiction" of the third party complaint. That ancillary jurisdiction does not exist is clearly laid down by the Supreme Court in *G. & C. Merriam Co. v. Saalfeld and Ogilvie*, 241 U.S. 22 (1916) and in *Fulton Nat. Bank v. Hozier*, 267 U.S. 276, 280 (1925) where the Court said:

"The general rule is that when a federal court has properly acquired jurisdiction over a cause it may entertain, by intervention, dependent or ancillary controversies; but no controversy can be regarded as dependent or ancillary unless it has direct relation to property or assets actually or constructively drawn into the court's possession or control by the principal suit. . . ."

The record discloses that this case involves no assets or property whatever in the possession or control of the court and there is therefore not the slightest foundation for appellants' suggestion of "ancillary jurisdiction."

Even where the attempted use of third party actions did not go so far as to try to mingle law and admiralty, as here, but only dealt with common law claims, the courts have held that the third party complaint may not be sustained in violation of ordinary rules of jurisdiction and venue, in reliance upon any such notion of ancillary jurisdiction or venue as Ap-

pellants advance. *Friend v. Middle Atlantic Transp. Co.*, 153 F.2d 778 (2nd Cir., 1946) cert. denied 328 U.S. 865; *Akers Motor Lines v. Newman*, 168 F.2d 1012 (5th Cir., 1948) cert. denied 335 U.S. 858; *R.F.C. v. Duke*, 14 F.R.D. 265 (D. Md., 1953).

Appellants rely upon the case of *United States v. Acord*, 209 F.2d 709 (10th Cir., 1954), which involved only a venue question rather than the jurisdictional question presented here. Not only is the *Acord* case contrary to the Supreme Court's holdings cited above, but also in conflict with the Tenth Circuit's own decisions, both before and after, in *Oils Inc. v. Blankenship*, 145 F.2d 354 (10th Cir., 1945) cert. denied 323 U.S. 803, and *Aetna Ins. Co. v. Chicago, Rock Island & P.R.R.*, 229 F.2d 584 (10th Cir., 1956). Had that court only consulted its own decisions it would have avoided the error into which it fell in *Acord*. There is no reason why this Court should now be asked to fall into the same error, or what is in truth a more grievous one.

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## II.

### APPELLANTS FAILED TO COMPLY WITH THE RESTRICTIONS OF THE SUITS IN ADMIRALTY ACT UPON THE PLACE OF SUIT.

Not only did the court below not have jurisdiction but the venue of Appellants' claim was incurably defective. The proper venue for Appellants' claim under the Suits in Admiralty Act is in one of the districts of New York, the state of Appellants' corporate residence.

The Suits in Admiralty Act provides, at 46 U.S.C. § 742, as follows:

“... Such suits shall be brought in the District Court of the United States for the district in which the parties are suing, or any of them, reside or have their principal place of business in the United States, or in which the vessel or cargo charged with liability is found . . .”

The sole allegation of the third party complaint relative to venue is the statement in Paragraph I (R. 7) that “third party plaintiff was and is a foreign corporation organized and existing under the laws of the State of New York, and at all times herein mentioned was and is doing business within the jurisdiction of this court.” From the start it has appeared on the record, therefore, that the venue of the claim lay in New York.

Nothing is better settled than the rule that suits against the United States can be maintained “only by permission of the United States, and in the manner and subject to the restrictions that it may see fit to impose.” *Reid v. United States*, 211 U.S. 529, 538 (1909). The strict conditions of suit against the United States apply to the place where suit is brought as well as to the subject matter of the suit. *Argonaut Navigation Co. v. United States*, 142 F. Supp. 489, 1956 A.M.C. 1698 (S.D. N.J.); *Simonsen v. United States*, 22 F. Supp. 239, 1938 A.M.C. 298 (E.D. Pa.); *United Merchants & Manufacturers, Inc. v. United States*, 123 F. Supp. 435 (M.D. Ga., 1954); *Miller v. United States*, 76 F. Supp. 523, 525 (W.D. Wash., 1948). Ap-



pellants may search in vain for any authority that the United States has consented to be sued by third party complaint in a district where it has not consented to be sued by original libel or complaint. Nor is it reasonable to suppose that the United States is willing to be sued in whatever district may be chosen by an original libelant or plaintiff who is a stranger making no claim whatsoever against the United States.

In accordance with these well-settled principles, an impleading petition against the United States may be filed under the Suits in Admiralty Act only in a district where the petitioner resides or has his principal place of business or in which the vessel or cargo charged with liability (in the case of *in rem* claims) is found. *The Ionian Leader*, 100 F. Supp. 829, 1952 A.M.C. 161 (D. N.J., 1951); *The Cotati*, 2 F.2d 394, 1924 A.M.C. 149 (S.D. N.Y., 1923). This rule follows the rule with respect to libels against the United States, plainly set forth in the Act and enforced in the following cases, among others: *Carroll v. United States*, 133 F.2d 690, 1943 A.M.C. 339 (2nd Cir.); *Untersinger v. United States*, 172 F.2d 298, 1949 A.M.C. 234 (2nd Cir.).

Not only must the petitioner observe the venue provisions of the Suits in Admiralty Act, but it must plead facts in its impleading petition showing that the venue is properly laid, and the petition will be dismissed for failure to do so. *The Cotati*, *supra*; *Sawyer v. United States*, 66 F. Supp. 271, 1946 A.M.C. 420 (S.D. N.Y.); *Piasecik v. United States*, 65 F. Supp. 430, 1944 A.M.C. 1350 (S.D. N.Y.).



Appellants, both New York corporations, plainly do not reside in Western Washington, the district of residence being in the state of incorporation. *Suttle v. Reich Bros. Construction Co.*, 333 U.S. 163 (1948). Appellants do not even contend that their principal place of business was within the Western District of Washington. Indeed, by failure to deny, or to reply in any way, third party plaintiffs admitted the statements of the Government's Request for Admission of Facts (R. 26) including the statements of non-residence and lack of principal place of business in the district (R. 28).

Both in the record and in their brief, Appellants have belabored at length the irrelevant question of the sometime presence of the SEACORONET in the Western District of Washington. Were Appellants' claim an *in rem* claim against the vessel, this point might have significance, but since the vessel was their own and they are not proceeding against her or charging liability against her, their contentions are without merit. In this action, which is not an *in rem* action, or an action on *in rem* rights or principles,<sup>6</sup> neither the vessel nor the cargo is "charged with liability" within the meaning of the Suits in Admiralty Act. Even if, in some loose sense, the claim against the United States could be considered to charge cargo with liability, it is uncontradicted in the record that the cargo

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<sup>6</sup>A libellant electing to proceed on *in rem* principles must so state in his libel. *Schnell v. United States*, 166 F.2d 479, 1948 A.M.C. 769 (2nd Cir.) cert. denied 334 U.S. 833; *Grillea v. United States*, 229 F.2d 687, 232 F.2d 919, 1956 A.M.C. 553, 1009 (2nd Cir.). There is no such election in this case.

was not located in the Western District of Washington. This was established by the Affidavit of Keith R. Ferguson (R. 14) and the Request for Admission of Facts and Genuineness of Documents (R. 26).

This case turns, of course, upon a manifest lack of jurisdiction, but because of the confusion of views reflected in the record and in Appellants' brief concerning the venue provisions of the Suits in Admiralty Act, counsel take this opportunity to explain to the Court the logic of those provisions and to demonstrate that they do not represent the kind of legal grab bag suggested by Appellants' contentions.

The Suits in Admiralty Act provides a remedy for both *in personam* and *in rem* rights, 46 U.S.C. § 743; *Johnson v. Fleet Corporation*, 280 U.S. 320, 1930 A.M.C. 1. When the Act, at 46 U.S.C. § 742, speaks of "vessel or cargo charged with liability," it refers only to actions upon *in rem* principles, based upon a maritime lien on the vessel or cargo. *The Elmac*, 285 Fed. 665 (S.D. N.Y., 1922); *The Anna E. Morse*, 287 Fed. 364, 368, 1923 A.M.C. 1049, 1054 (S.D. Ala.); see *The Henry S. Grove*, 287 Fed. 247, 250, 1923 A.M.C. 366, 369 (W.D. Wash.).

Thus, the result is that where an *in rem* claim is made, the libelant may choose to sue in the district where the *res* is found at the time the libel is filed<sup>7</sup> or

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<sup>7</sup>There is a suggestion by Appellants' counsel in the record (R. 79) that presence of the *res* at any time during the action might be adequate. But presence at the time the libel is filed is what is required. *Untersinger v. United States*, 172 F.2d 298, 1949 A.M.C. 234 (2nd Cir.). The court below correctly considered that presence at the time of filing the libel would be necessary. "You either have

in the district of libelant's residence or principal place of business; but where, as here, only an *in personam* claim is presented and there is no *res* involved, the libelant must sue only at its residence or principal place of business. As the court said in *The Anna E. Morse*, *supra*, "To this extent, at least, the act gives no alternative venue in proceedings in personam . . ." This entire arrangement of venue concurs and harmonizes with similar distinctions as to jurisdiction of *in rem* and *in personam* claims, in accordance with *Blamberg Bros. v. United States*, 260 U.S. 452, 1923 A.M.C. 50, under which jurisdiction of *in rem* claims under the Suits in Admiralty Act depends upon the actual presence of the vessel or cargo within the jurisdiction.

Appellants make much of *Hoiness v. United States*, 335 U.S. 297, 1948 A.M.C. 1909. *Hoiness* holds only that the venue provisions of the Suits in Admiralty Act may be waived. But there is no waiver here. On the contrary, the record shows that the United States objected at the earliest moment and repeatedly thereafter to the improper venue and the failure to plead facts showing venue. These were among the grounds of the Government's motion to dismiss (R. 12) which was denied with leave to renew (R. 21). At the opening of trial the Government renewed and reserved all the grounds of its motion and its objections already made, and Government counsel stated that the Government was present only to protect its record on such

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to have the thing here or you have to have the United States as the *owner* of the thing here, and the time when the thing was here that is important is the time of the commencement of the action . . ." (emphasis supplied) (R. 79).

objections (R. 49). Subsequently (R. 53-54) the Court granted the Government's request that its objections already made be deemed continuing. At the opening of proceedings on the third party complaint, Government counsel again renewed all its objections to the trial (R. 57). And, finally, when evidence of the presence of the SEACORONET at Seattle was offered, Mr. Staring, for the Government, objected that such evidence was irrelevant and immaterial (R. 59, 67) and consistently maintained that objection, pointing out to the court once again (R. 81) that the third party complaint was devoid of any allegation under which any proof of venue could be made. If ever there was a case in which care was taken not to waive venue, this is that case.

The court below correctly dismissed the third party complaint for failure to plead facts showing consent of the United States to be sued in the Western District of Washington and for the actual absence of such consent, as abundantly shown by the record.

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### III.

#### **THE DISTRICT COURT CORRECTLY DENIED APPELLANTS' MOTION TO TRANSFER.**

After having chosen the court below in which to sue the United States, third party plaintiffs, after more than a year's notice of the Government's defenses, within which they could have brought a proper libel in the proper venue, and after filing the notice which commenced this appeal, sought to have the court below



transfer half of this case to another district, without justification in principle or precedent and in defiance of the jurisdiction of this Court of Appeals.<sup>8</sup> Nothing in 28 U.S.C. § 1406 authorizes a court without jurisdiction to take jurisdiction in order to transfer such a case. Section 1406 permits only the transfer for defective venue of cases of which the court has jurisdiction.

Since the court in this case lacked jurisdiction of the third party action from the outset, it manifestly could not have granted Appellants' motion to transfer the third party complaint to New York, even if the motion had otherwise had any merit. *Burns v. Chubb*, 99 F. Supp. 581 (E.D. Pa., 1951); *Fistel v. Beaver Trust Co.*, 94 F. Supp. 974 (S.D. N.Y., 1950; *Scar-*

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<sup>8</sup>This appeal was started by a notice of appeal (R. 33) filed July 17, 1956. The notice (R. 39) filed September 7, 1956 did no more than broaden the scope of the appeal to include the dismissal of the third party complaint. This brings to light that, for an additional reason, the court below lacked jurisdiction to entertain the motion for transfer. Although the first notice of appeal was premature when filed, upon the entry of the order of July 27, 1956, dismissing the third party complaint, which was a final order since it disposed of the remainder of the claim [Civil Rule 54(b); *In re Forster Chain Corp.*, 177 F.2d 572 (1st Cir., 1949)] the judgment entered earlier on June 20, 1956 in favor of plaintiff became final and the notice of appeal on file became effective under the controlling decisions of the Supreme Court in *Lemke v. United States*, 346 U.S. 325 (1953) and *Luckenbach S.S. Co. v. United States*, 272 U.S. 533 (1926). An appeal having been effectively taken, the case was exclusively within the jurisdiction of the Court of Appeals and the court below had no further jurisdiction over the judgments and orders entered. *The Rio Grande*, 23 Wall. 458 (1875). Any notion that a portion of a third party action may remain within the jurisdiction of the district court in these circumstances is put to rest by the language of Civil Rule 54(b) itself and by the policy underlying that rule and 28 U.S.C. § 1291, which is that appeals from cases such as this shall not go up piecemeal, on one part of the case at a time. *Catlin v. United States*, 324 U.S. 229 (1945).



*modo v. Mooring*, 89 F. Supp. 936 (S.D. Tex., 1950); *Dell v. American Export Lines v. United States*, 142 F. Supp. 511, 1956 A.M.C. 1567 (S.D. N.Y.). From the *Dell* case it appears, moreover, that such a transfer, if made, would very properly be refused by the court in New York. Upon its appearing that the court lacked jurisdiction, the only course it was empowered to take was to dismiss, as it did. *Joy v. Hague*, 175 F. 2d 395 (1st Cir., 1949) cert. denied 338 U.S. 870; *Battaglia v. General Motors Corp.*, 169 F. 2d 254 (2nd Cir., 1948), cert. denied 335 U.S. 887.

The suggested transfer of part of a third party action does violence to the very purpose of such an action. Appellants can show no authority for such a transfer for the obvious reason that a three party action is only one suit. See *Glens Falls Indemnity Co. v. Atlantic Bldg. Corp.*, 199 F. 2d 60 (4th Cir. 1952); *Piedmont Interstate Fair Assn. v. Bean*, 209 F. 2d 942 (4th Cir., 1954); *Thomas v. Malco Refineries*, 214 F. 2d 884 (10th Cir., 1954). And the purpose of Civil Rule 14, on which third party plaintiffs have relied, is not to "enable a single lawsuit to be converted into two." *Brown v. First Nat. Bank*, 14 F.R.D. 339, 340 (E.D. Okla., 1953).

The transfer of a portion of the case would have presented a flagrant abuse of Civil Rule 14, the very object of which is to bring claims into one suit, by imposing upon the United States two separate trials in two separate courts in what purports to be one case. After the two trials would come two appeals, the one already pending in this Court at that time and then

another, from the judgment on the third party complaint, in the Court of Appeals for the Second Circuit. Thus two courts of appeals would be asked to pass upon interdependent questions of liability arising in large part from the same record of trial. Such a preposterous and confusing imposition upon the courts was never intended and can not be justified in the transfer statute. It may fairly be said that the attempt to transfer would have been an inexcusable affront to the jurisdiction of this Court of Appeals by attempting to deprive this Court of jurisdiction of part of a case when the case was then actually on appeal before it.

The Appellants, from their conduct of this and the related litigation, were scarcely entitled to claim any special consideration from the court below, even had the court had the power to give it. This complex of cases presents a clear abuse of judicial procedures. Not only did Appellants sue the United States separately in the seven cases now consolidated on appeal here (R. 99) but in three other cases<sup>9</sup> in the same court below, which were voluntarily dismissed by the libelants without collection. In addition, Appellants filed the libel in the Southern District of New York set forth in Appendix B and, as recently as Mar. 6, 1957, filed, inexplicably, another third party complaint

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<sup>9</sup>*Basnight v. Orion Shipping & Trading Co. and Pacific Cargo Carriers v. United States*, W.D. Wash., Admiralty No. 16059; *Morriss v. Orion Shipping & Trading Co. and Pacific Cargo Carriers v. United States*, W.D. Wash., Admiralty No. 16060; *Wilcox v. Orion Shipping & Trading Co. and Pacific Cargo Carriers v. United States*, W.D. Wash., Admiralty No. 16061.

at law, this time in New York (Appendix F). All this in the face of the fact that the single libel in New York could have been drawn to claim indemnity for all the various seamen's suits against Appellants for chlorine injuries wherever in the country they were pending<sup>10</sup>.

Instead of following the simple and rational course of a single libel in New York, with a single trial and a single record, Appellants have harassed the United States with all the several suits pointed out above and have, in the main, used third party procedure to accomplish this multiplicity of action. What is more, upon receiving the warning of Judge Lindberg's dismissal of the *Aregood* case (R. 6) and upon being further warned by Judge Bowen's order (R. 21) that the jurisdictional and other objections of the Government would remain open for decision at trial, Appellants, over many months, did nothing to protect their claim by bringing a proper suit in admiralty. Against this record, the refusal of the judge to exercise his discretion to transfer had he had any discretion, would have been fully justified.

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<sup>10</sup>A libel in admiralty would not, as Appellants suggest (R. 94), have been subject to dismissal for prematurity. 2 Benedict, *Admiralty* 77 (6th ed.) and cases cited there. Such a libel would not in fact have been premature at any time after the chlorine incident, since the cause of action, if any, was then complete, only the amount of damages remaining to be ascertained. *Wilcox v. Plummer*, 4 Pet. 172 (1830); *United States v. Atlantic Mutual Ins. Co.*, 298 U.S. 483, 1936 A.M.C. 993.

**CONCLUSION.**

For all of the foregoing reasons, but primarily because the lower court lacked jurisdiction from the outset, the decision of the lower court should be affirmed.

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(Appendices A, B, C, D, E and F Follow.)

## **Appendices.**





## Appendix A

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### STATUTES AND RULES.

The pertinent provisions of the suits in admiralty act, 46 U.S.C. §§ 741 *et seq.* read as follows: § 741. Exemption of United States vessels and cargoes from arrest or seizure—No vessel owned by the United States or by any corporation in which the United States or its representatives shall own the entire outstanding capital stock or in the possession of the United States or of such corporation or operated by or for the United States or such corporation, and no cargo owned or possessed by the United States or by such corporation, shall, in view of the provisions herein made for a libel in personam, be subject to arrest or seizure by judicial process in the United States or its possessions . . .”

§ 742. Libel in personam—In cases where if such vessels were privately owned or operated, or if such cargo were privately owned and possessed, a proceeding in admiralty could be maintained at the time of the commencement of the action herein provided for, a libel in personam may be brought against the United States or against any corporation mentioned in section 741 of this title, as the case may be, provided that such vessel is employed as a merchant vessel or is a tugboat operated by such corporation. Such suits shall be brought in the district court of the United States for the district in which the parties so suing, or any of them, reside or have their principal place of busi-

ness in the United States, or in which the vessel or cargo charged with liability is found. . . .

§ 743. Procedure in cases of libel in personam. . . .  
If the libelant so elects in his libel, the suit may proceed in accordance with the principles of libels in rem wherever it shall appear that had the vessel or cargo been privately owned and possessed a libel in rem might have been maintained. . . .

Rule 56 of the Rules of Practice in Admiralty and Maritime Cases provides as follows: In any suit, whether in rem or in personam, the claimant or respondent (as the case may be) shall be entitled to bring in any other vessel or person (individual or corporation) who may be partly or wholly liable either to the libelant or to such claimant or respondent by way of remedy over, contribution or otherwise, growing out of the same matter. This shall be done by petition, on oath, presented before or at the time of answering the libel, or at any later time during the progress of the cause that the court may allow. Such petition shall contain suitable allegations showing such liability, and the particulars thereof, and that such other vessel, or person ought to be proceeded against in the same suit for such damage, and shall pray that process be issued against such vessel or person to that end. Thereupon such process shall issue, and if duly served, such suit shall proceed as if such vessel or person had been originally proceeded against; the other parties in the suit shall answer the petition; the claimant of such vessel or such new party shall answer the libel; and such further proceedings shall be had and

decree rendered by the court in the suit as to law and justice shall appertain. But every such petitioner shall upon filing his petition, give a stipulation, with sufficient sureties, or an approved corporate surety, to pay the libellant and to any claimant or any new party brought in by virtue of such process, all such costs, damages, and expenses as shall be awarded against the petitioner by the court on the final decree, whether rendered in the original or appellate court; and any such claimant or new party shall give the same bonds or stipulations which are required in the like cases from parties brought in under process issued on the prayer of a libellant.

The pertinent provisions of the Federal Rules of Civil Procedure read as follows:

Rule 14. Third-Party Practice—(a) When Defendant May Bring in Third Party. Before the service of his answer a defendant may move *ex parte* or, after the service of his answer, on notice to the plaintiff, for leave as a third-party plaintiff to serve a summons and complaint upon a person not a party to the action who is or may be liable to him for all or part of the plaintiff's claim against him. If the motion is granted and the summons and complaint are served, the person so served, hereinafter called the third-party defendant, shall make his defenses to the third-party plaintiff's claim as provided in Rule 12 and his counterclaims against the third-party plaintiff and cross-claims against other third-party defendants as provided in Rule 13. The third-party defendant may assert against the plaintiff any defenses which the

third-party plaintiff has to the plaintiff's claim. The third-party defendant may also assert any claim against the plaintiff arising out of the transaction or occurrence that is the subject matter of the plaintiff's claim against the third-party plaintiff. The plaintiff may assert any claim against the third-party defendant arising out of the transaction or occurrence that is the subject matter of the plaintiff's claim against the third-party plaintiff, and the third-party defendant thereupon shall assert his defenses as provided in Rule 12 and his counterclaims and cross-libels as provided in Rule 13. A third-party defendant may proceed under this rule against any person not a party to the action who is or may be liable to him for all or part of the claim made in the action against the third-party defendant.

\* \* \*

## Rule 81. Applicability in General

### (a) To What Proceedings Applicable

(1) These rules do not apply to proceedings in admiralty. . . .

Rule 82. Jurisdiction and Venue Unaffected—These rules shall not be construed to extend or limit the jurisdiction of the United States district courts or the venue of actions therein.



## Appendix B

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AMENDED LIBEL IN PACIFIC CARGO CARRIERS CORP. v.  
UNITED STATES S.D. N.Y., ADMIRALTY NO. 189-35.

To the Honorable the Judges of the United States  
District Court for the Southern District of New York:

The amended libel and complaint of  
PACIFIC CARGO CARRIERS CORP., as  
Owner of the S.S. SEACORONET  
against

UNITED STATES OF AMERICA, in a cause  
of contract and indemnity, civil and  
maritime, alleges upon information  
and belief, as follows:

### FOR A FIRST CAUSE OF ACTION

First: At all the times hereinafter mentioned, the libelant, Pacific Cargo Carriers Corp., was and now is a corporation organized and existing under and by virtue of the laws of the State of New York, with an office and place of business at No. 80 Broad Street, in the City, County and State of New York, and was the owner of the S. S. SEACORONET, which, prior to the occurrences hereinafter described, was tight, staunch, strong and in all respects seaworthy.

Second: Respondent, the United States of America, a corporate sovereign, was at all times hereinafter mentioned, through its Department of the Navy, (Military Sea Transportation Service) the Time Charterer of the said vessel, and has by law consented to be sued herein.

Third: On or about the 22nd day of April, 1952, libelant and respondent entered into a written time charter party (NSTS Contract No. 1102) wherein and whereby libelant, as owner, agreed to and did let, and respondent, as Charterer, agreed to and did hire the S. S. SEACORONET, upon the terms and conditions set forth in said time charter party and written extensions thereof. A true copy of said charter party and the extensions thereof, are annexed hereto, made a part hereof and marked Exhibit "A".

Fourth: On or about August 17, 1953, while the aforesaid time charter was in force and effect, the S. S. SEACORONET, was, pursuant to directions of respondent and in accordance with the terms and conditions of the said contract of time charter, at the port of Pusan, Korea.

Fifth: At the said port of Pusan, Korea, and on the said date, respondent was, pursuant to the terms of the aforesaid contract of charter party, loading a cargo into the holds of the S. S. SEACORONET. The said cargo consisted in part, of gas cylinders, which the Master and officers of the said vessel had been informed and believed were empty and, free of gas. At about 2230 hours on said date, and while the said gas cylinders were being loaded by personnel engaged by, and under the supervision and control of respondent, a gas cylinder was caused to be loaded into the No. 5 hold of the vessel. Said gas cylinder was either defective or was otherwise damaged, during the loading operation and was not empty and free of contents, but on the contrary contained harmful and

poisonous gas, and said gas was permitted by respondent, its agents, servants and/or employees, to escape and penetrate various compartments of the vessel, including, among others, the crew quarters.

Sixth: The aforesaid escape of harmful and poisonous gas, at the time and on the occasion hereinbefore referred to, was due to the failure and neglect on the part of respondent, and/or those under its control, to comply with and properly perform the duties and obligations of respondent, under the terms of the aforesaid contract of charter party in that the said cargo of gas cylinders was not properly loaded and due care was not given to the stowage thereof, and respondent knew, or should have known, such cargo was of a dangerous and poisonous nature, and respondent loaded such dangerous and poisonous cargo at its own risk.

Seventh: The escape of the harmful and poisonous gas, at the time and on the occasion heretofore referred to herein, was not due to any fault, neglect or want of care on the part of the S. S. SEACORONET or on the part of libellant, its agents, servants or employees, or on the part of the officers and crew of the S. S. SEACORONET, nor was the said cargo, or the loading thereof, under libellant's control.

Eighth: Under the terms and conditions of the aforesaid contract of charter party, the respondent was required to and did assume all responsibility for the loading and discharging of the S. S. SEACORONET and for the acts or failures to act of the persons engaged by it to accomplish the loading and discharging.

Ninth: At the times heretofore referred to herein, libelant had in its employ, as a member of the crew of the S. S. SEACORONET, one Robert L. Wilson, who served thereon in the capacity of Third Cook and Messman.

Tenth: The said Robert L. Wilson as a member of the crew of the said vessel, was lawfully aboard same on the 17th day of August, 1953, when the said vessel was at the port of Pusan, Korea. Alleging exposure to and contact with the harmful and poisonous gas fumes which escaped from a gas cylinder, as heretofore described herein, said Robert L. Wilson has made claim against libelant for damages and has asserted, that by reason of contact with said gas fumes, he was rendered sick and sustained severe and permanent personal injuries.

Eleventh: Heretofore, and on or about the 23rd day of June, 1954, the said Robert L. Wilson commenced an action against libelant and its managing agent, Orion Shipping & Trading Co., Inc., wherein and whereby he sought recovery of damages in the amount of \$6,000.00, of and from the libelant, as his employer, for the alleged injuries and/or illnesses resulting from contact with harmful and poisonous gas, under the circumstances and at the time heretofore referred to herein. Said action against libelant and its managing agent, was commenced by the said Robert L. Wilson in the City Court of the City of New York County of New York (Index #T681/54). A true copy of the complaint of said Robert L. Wilson, to said action, is annexed hereto, made a part hereof and marked Exhibit "B".



Twelfth: Libelant denied that it was in any way responsible for the illness and/or injuries as alleged by said Robert L. Wilson, but admitted that as employer of the crew of the S. S. SEACORONET it owed to said person an obligation to provide a safe place in which to work and warranted to him, by implication of law, the seaworthiness of the said vessel.

Thirteenth: Heretofore, libelant, through the Master of the S. S. SEACORONET, gave due notice to respondent through its Department of the Navy (Military Sea Transportation Service) of the incident concerning the escape, from a cylinder, of the poisonous gas heretofore referred to herein, and respondent had actual knowledge thereof. Thereafter, and by letter dated February 26, 1955, the attorneys for libelant gave due notice to respondent of the pendency of the aforesaid action of the said Robert L. Wilson, in the City Court of the City of New York, County of New York, and respondent was thereby called upon to assume and/or assist in the defense of the said City Court action and respondent was informed that upon its failure to do so, and in the event of a recovery by the plaintiff therein, libelant would look to respondent for reimbursement. Said letter was directed by registered mail to respondent through its United States Attorney for the Southern District of New York, and a copy thereof was sent to respondent's Attorney in Charge, Admiralty & Shipping Section of its Department of Justice. Thereafter, respondent was duly informed by the attorneys for libelant, by letter dated February 27, 1956, and addressed to the said Attorney in Charge of its Department of Justice, Admiralty



& Shipping Section at the U. S. Courthouse, Foley Square, New York, New York, that the said action of Robert L. Wilson against libelant, pending in the said City Court of the City of New York, County of New York, had been called on the trial calendar of said Court on the 23rd day of February, 1956 and that in accordance with the procedure followed in said City Court of the City of New York, the Justice then presiding explored with counsel for the respective parties, the possibilities of settlement, and that as a result of said conference with the Court, the Justice there presiding, suggested that the case be compromised and settled for the sum of \$750.00, over and above the sum of \$136.00, which had earlier been paid by libelant to said Robert L. Wilson for maintenance and cure due to said Robert L. Wilson under the General Maritime Law of the United States.

Fourteenth: Respondent refused and neglected to take any part, either in the defense of the said action of said Robert L. Wilson, or in the settlement thereof.

Fifteenth: Libelant was advised by its attorneys, in the light of the probabilities of said Robert L. Wilson being successful, in ultimately recovering a judgment against it, in excess of the amount at which the action could be compromised and settled, and in view of the recommendation of settlement, made by the Justice presiding at the settlement conference heretofore referred to herein, that a settlement and compromise of said action for the sum of \$750.00, in addition to the sum of \$136.00 which had been earlier advanced to said Robert L. Wilson for maintenance and cure, was reasonable and prudent and in the best interests of libelant.

Sixteenth: Thereafter, respondent having refused and neglected to approve said compromise and settlement and to admit its liability therefor, and libelant, being satisfied that the said settlement and compromise of the aforesaid action of Robert L. Wilson, upon the basis heretofore stated herein, was reasonable and prudent, approved said settlement and compromise.

Seventeenth: As a result of the foregoing, libelant had good cause to and did pay to the said Robert L. Wilson the sums of \$750.00 and \$136.00 as heretofore mentioned herein, and in addition, libelant has necessarily incurred, and did pay, legal expenses and disbursements, in the amount of \$344.65, as a result of the aforesaid action brought by the said Robert L. Wilson.

Eighteenth: Thereafter, the said compromise and settlement was duly accomplished, and on or about June 19, 1956, libelant paid to said Robert L. Wilson, the sum of \$750.00 (the sum of \$136.00 having been earlier paid to him), and libelant obtained a release from said Robert L. Wilson executed on the 15th day of June, 1956 and the aforesaid action, pending in the City Court of the City of New York, County of New York, was duly discontinued, of record.

Nineteenth: By reason of the premises aforesaid and in consequence of the matters heretofore stated herein, libelant has sustained damages in the amount of One Thousand Two Hundred Thirty and 65/100 Dollars (\$1,230.65), no part of which has been paid by respondent to libelant although duly demanded.

Twentieth: It is the duty of respondent, by reason of the matters aforesaid and pursuant to the terms and conditions of the contract of charter party, heretofore described herein, to indemnify libelant for its damages, as aforesaid, in the said amount of \$1,230.65 as set forth herein.

Twenty-First: Libelant elects to proceed herein on *in personam* principles under the Suits of Admiralty Act (46 U.S.C. 741, et seq.).

Twenty-Second: All and singular the premises are true and within the admiralty and maritime jurisdiction of the United States and of this Honorable Court.

#### FOR A SECOND CAUSE OF ACTION

Twenty-Third: Libelant repeats and realleges, as fully as though herein again set forth at length, each and every allegation contained in Articles First through Eighth, inclusive, Twenty-First and Twenty-Second of this amended libel.

Twenty-Fourth: At the times heretofore referred to herein, libelant had in its employ as members of the crew of the SS SEACORONET the following seamen who served in the following capacities:

Charles E. Aregood, Chief Steward;  
Joseph Mitchell, Ordinary Seaman;  
George Lewis, Deck Maintenance;  
Willie Holmes, Third Cook;  
Willie B. Basnight, Utility Man;  
Arthur G. B. Morriss, Chief Mate;  
Ben Wilcox, 2nd Assistant Engineer.

Twenty-Fifth: The seamen named in Article Twenty-Fourth hereof as members of the crew of the S.S. SEACORONET were lawfully aboard same on the 17th day of August, 1953, when the said vessel was at the Port of Pusan, Korea. Alleging exposure to and contact with the harmful and poisonous gas fumes which escaped from a gas cylinder, as heretofore described herein, the said seamen made claim against libelant for damages, and asserted that by reason of contact with said gas fumes, they were rendered sick and sustained severe and permanent personal injuries.

Twenty-Sixth: Heretofore and on various dates, seamen Aregood, Mitchell, Lewis and Holmes commenced actions against libelant in the United States District Court for the Western District of Washington, Northern Division, and seamen Basnight, Morriss and Wilcox commenced actions against libelant in the United States District Court for the Eastern District of Pennsylvania, wherein and whereby they sought recovery of damages in varying amounts of and from the libelant as their employer for the alleged injuries and/or illnesses resulting from contact with harmful and poisonous gas, under the circumstances and at the time heretofore referred to herein. The said actions brought by seamen Basnight, Morriss and Wilcox in the United States District Court for the Eastern District of Pennsylvania were subsequently transferred on order of the said Court to the United States District Court for the Western District of Washington, Northern Division, and there consolidated for purposes of trial with the actions there originally brought.



Twenty-Seventh: Libelant denied that it was in any way responsible for the illnesses and/or injuries as alleged by the said seamen, but admitted that as employer of the crew of the S.S. SEACORONET, it owed to such persons an obligation to provide a safe place in which to work and warranted to them, by implication of law, the seaworthiness of the said vessel.

Twenty-Eighth: Heretofore, libelant, through the Master of the S.S. SEACORONET, gave due notice to respondent through its Department of the Navy (Military Sea Transportation Service) of the incident concerning the escape, from a cylinder, of the poisonous gas heretofore referred to herein, and respondent had actual knowledge thereof.

Twenty-Ninth: Thereafter, the respondent was impleaded in the said actions brought as set forth in Article Twenty-Sixth on the ground that it was or might become liable to libelant for any monies it was called upon to pay. Respondent became a party defendant thereto and was represented by counsel at the subsequent trial of the actions.

Thirtieth: The trial of the actions aforesaid resulted in jury verdicts for the plaintiff seamen in varying amounts against libelant and thereafter judgments were entered upon said verdicts. The United States District Judge presiding at the trial having reserved to himself decision as to the right of libelant to indemnity, subsequently dismissed the claim without prejudice on the ground that the Court lacked jurisdiction of the respondent. Appeals were noticed from the judgments in favor of the said seamen but



were subsequently discontinued when upon consideration of the record, it was deemed in the best judgment of counsel that no reversible error had been committed. Respondent was given due notice of the decision to discontinue the appeals and to pay the judgments with interest then owing and was requested to take over the prosecution of the appeals if it so desired. Respondent, however, refused to do so. The amounts paid in satisfaction of the judgments totaled \$148,438.80. Annexed hereto marked Exhibit "C" and made a part hereof is a schedule of the amounts paid to the plaintiff seamen by libelant.

Thirty-First: The payment of the judgments as aforesaid was reasonable and prudent and in the best interests of libelant and respondent since it stopped the incurrence of further interest and costs.

Thirty-Second: In addition to the payment of the amount set forth in Article Thirty libelant necessarily incurred and paid legal expenses and disbursements in the total amount of \$7,603.75 in defending the actions hereinabove mentioned.

Thirty-Third: By reason of the premises aforesaid and in consequence of the matters heretofore stated herein, libelant has sustained damages in the amount of \$156,042.55, no part of which has been paid by respondent to libelant although duly demanded.

Thirty-Fourth: It is the duty of respondent, by reason of the matters aforesaid and pursuant to the terms and conditions of the contract of charter party, heretofore described herein, to indemnify libelant for

its damages in the said amount of \$156,042.55 as set forth herein.

Wherefore, libelant prays, that respondent, the United States of America, may be required to appear and answer under oath all and singular the matters aforesaid, that this cause may be heard and determined according to the principles of law and the rules of practice obtaining in like causes between private parties; that this Honorable Court may render a decree in favor of libelant awarding it its damages in the amount of \$1,230.65 on the first cause of action alleged herein, and \$156,042.55 on the second cause of action alleged herein, with interest and costs, and that libelant may have such other and further relief as may be just and proper.

NELSON, HEALY, BAILLIE & BURKE,  
Proctors for Libelant,  
52 Wall Street,  
New York 5, New York.

(Verification and attachments omitted.)

## Appendix C

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PROPOSED THIRD PARTY COMPLAINT AND ORDER DENYING  
LEAVE TO FILE IT IN OSTROM v. WEYERHAEUSER STEAM-  
SHIP CO., W.D. WASH., CIVIL NO. 4255.

### EXHIBIT "A"

[Title of Court and Cause.]

### THIRD PARTY COMPLAINT

Comes now the defendant and third party plaintiff, Weyerhaeuser Steamship Co., a corporation, and for its third party complaint against the United States of America alleges as follows:

#### I.

The plaintiff, Reynold E. Ostron, has filed against defendant, Weyerhaeuser Steamship Co., a corporation, a complaint, copy of which is hereto attached as Exhibit "B." The defendant thereafter removed the cause of action to the United States District Court, Western District of Washington, Northern Division, the same being the above-numbered cause.

#### II.

That the plaintiff's injuries, if any, were solely and wholly caused by the negligent navigation of the United States Government Dredge "Pacific" which collided with defendant's merchant vessel "F. H. Weyerhaeuser."

#### III.

That the negligent navigation of the United States Government Dredge "Pacific" causing said injuries

to the plaintiff consisted of the following acts and omissions of the officers and crew of the United States Government Dredge "Pacific" occurring immediately prior to the collision:

(A) The Dredge "Pacific" failed to keep a proper or sufficient lookout;

(B) The Dredge "Pacific" was proceeding at an excessive rate of speed in view of fog conditions then prevailing;

(C) The Dredge "Pacific" failed to stop and reverse its engines when it heard the fog signal of defendant's vessel "F. E. Weyerhaeuser";

(D) The Dredge "Pacific" failed to alter its course when it became apparent that a collision between it and the S.S. "F. E. Weyerhaeuser" was imminent and failed to sound the danger signal.

Wherefore, defendant and third party plaintiff demand judgment against third party defendant for full indemnity or contribution for all sums that may be adjudged against defendant Weyerhaeuser Steamship Co., a corporation, in favor of the plaintiff, Reynold E. Ostron, in addition to all sums expended by defendant and third party plaintiff in defending this action.

BOGLE, BOGLE & GATES

EDW. S. FRANKLIN.

*Attorneys for Third Party Plaintiff.*

United States of America  
Western District of Washington  
Northern Division—ss.

Edward S. Franklin, being first duly sworn, on oath deposes and says:

That he is one of the attorneys for the third party plaintiff above named; that he makes this verification for and on behalf of said third party plaintiff as he is authorized to do; that he has read the foregoing Third Party Complaint, knows the contents thereof and believes the same to be true.

EDW. S. FRANKLIN.

Subscribed and sworn to before me this 27th day of December, 1956.

(Seal)

RONALD E. MCKINSTRY

Notary Public in and for the State of  
Washington, residing at Seattle.



[Title of Court and Cause.]

ORDER DENYING MOTION TO BRING IN  
THIRD PARTY DEFENDANT.

This matter having come on regularly for hearing upon the motion of the Weyerhaeuser Steamship Co., a corporation, for leave to make the United States of America a party to this action, the Weyerhaeuser Steamship Co., defendant, appearing through Bogle, Bogle & Gates and Edward S. Franklin, its attorneys, and the United States of America appearing specially and objecting to the jurisdiction of the court as to the United States of America, and the court having listened to the argument of counsel and having considered the memorandum of authorities filed herein and having examined the pleadings and it appearing to the court that if the defendant and proposed third party plaintiff had sought to institute the cause of action alleged by it in its proposed third party complaint independently in this district against the United States of America, the court would have no jurisdiction over the United States of America and over the objections of the United States of America would be unable to compel the United States of America to submit to the court's jurisdiction; and it appearing further to the court that if it would have no jurisdiction to compel the United States of America to respond to a direct action of the type which the defendant and proposed third party plaintiff attempts to assert here, it likewise is without jurisdiction or power to compel the United States to submit to this court's jurisdiction under the impleador provisions of Rule 14 of the Fed-

eral Rules of Civil Procedure, and the court being fully advised in the premises, now, therefore.

It is hereby ordered that the objections of the United States of America, appearing specially, to this court's jurisdiction are sustained and the action of the Weyerhaeuser Steamship Co., defendant, for leave to make the United States of America a party to this action be, and the same is hereby denied.

Done in open court this 20th day of February, 1957.

JOHN C. BOWEN,  
*United States District Judge.*

Presented and approved by:

WILLIAM A. HELSELL,  
*Assistant United States Attorney.*

Approved as to form.

*Notice of presentation waived.*

BOGLE, BOGLE & GATES.

BY EDW. S. FRANKLIN,  
*Attorneys for Defendant*  
*Weyerhaeuser Steamship Co.*

## Appendix D

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**THIRD PARTY COMPLAINT, MOTION TO DISMISS THIRD PARTY COMPLAINT AND ORDER OF DISMISSAL IN DURANT v. COASTWISE LINE v. UNITED STATES, S.D. CAL., CIVIL NO. 19,544.**

[Title of Court and Cause.]

Third party plaintiff Coastwise Line, a corporation, complains of third party defendant and alleges:

### I

Plaintiff Richard C. Durant has filed against Coastwise Line, a corporation, a complaint, copy of which is attached hereto and marked "Exhibit A", and by this reference incorporated herein.

### II

That plaintiff Richard C. Durant alleges that on or about February 24, 1955, while aboard the S.S. JAMES LICK, a vessel owned and operated by third party plaintiff, he received a personal injury.

### III

That at said time and place third party defendant United States of America was engaged in loading and unloading a portion of said vessel, to wit, No. 2 hold, through the use of certain military forces of the United States at the Port of Whittier, Alaska.

### IV

That if at said time and place, as alleged by plaintiff, the said S.S. JAMES LICK was in anywise un-

seaworthy or if the place where plaintiff was working was in an unsafe and dangerous condition, said unseaworthiness and/or unsafe and dangerous condition was caused and created solely by reason of the acts of said third party defendant, its agents, servants and employees.

## V

That if plaintiff received any injury while aboard the S.S. JAMES LICK on or about February 24, 1955, as a result of any unseaworthy and/or unsafe and dangerous condition which may entitle him to recover damages against third party plaintiff, then third party defendant, United States of America, is responsible over to third party plaintiff for all such damages and expenses arising therefrom.

WHEREFORE, Coastwise Line, a corporation, demands judgment against third party defendant United States of America, for all sums which may be adjudged in the first instance against defendant and in favor of plaintiff.

Lillick, Geary, McHose, Roethke & Myers,  
Gordon K. Wright,

By .....

Attorneys for Defendant and Third  
Party Plaintiff, Coastwise Line, a  
corporation.

[Title of Court and Cause.]

MOTION TO DISMISS THIRD PARTY COMPLAINT UNDER RULE 12(d) FEDERAL RULES OF CIVIL PROCEDURE.

NOTICE OF MOTION.

Comes now third party defendant United States of America and moves the Court to dismiss the third party complaint on file herein upon the following grounds:

I.

The Court lacks jurisdiction of third party plaintiff's alleged claim in that the Suits in Admiralty Act, 46 U.S.C. Secs. 741 *et seq.*, does not confer jurisdiction upon this Court in an action at law.

II.

The Court lacks jurisdiction of third party plaintiff's alleged claim in that the Federal Tort Claims Act, 28 U.S.C. Secs. 1346(b), 2671 *et seq.*, does not confer jurisdiction upon this Court, plaintiff's alleged claim being exclusively within the jurisdiction of the Suits in Admiralty Act and therefore excepted from the Federal Tort Claims Act by 28 U.S.C. Sec. 2680(d).

III.

The Court lacks jurisdiction of third party plaintiff's alleged claim in that the Federal Tort Claims Act, 28 U.S.C. Secs. 1346(b), 2671 *et seq.*, does not confer jurisdiction upon this Court in causes of indemnity or other causes not sounding in Tort.

IV.

Third party plaintiff has failed to allege facts showing that the venue is properly laid in the Southern



## V.

The venue of the third party complaint is improperly laid in the Southern District of California in that third party plaintiff does not reside in the Southern District of California and the act complained of did not occur in the said District, as required by 28 U.S.C. Sec. 1402(b).

## VI.

The venue of the third party complaint is improperly laid in the Southern District of California in that third party plaintiff does not reside or have its principal place of business in the Southern District of California and the cargo sought to be charged with liability is not found in the said District, as required by 46 U.S.C. Sec. 742.

## VII.

The third party complaint fails to state a cause of action against third party defendant, United States of America.

Laughlin E. Waters,  
United States Attorney,  
Max F. Deutz,  
Assistant United States  
Attorney,  
Keith R. Ferguson,  
Special Assistant to the  
Attorney General,  
Attorneys for Third Party Defendant,  
United States of America.

[Title of Court and Cause.]

ORDER GRANTING MOTION TO DISMISS  
THIRD PARTY COMPLAINT.

The above entitled matter having come on for hearing on January 28, 1957, before the Honorable Leon R. Yankwich, on a motion to dismiss the Third Party Complaint, brought by the Third Party Defendant United States of America, through Laughlin E. Waters, United States Attorney, Keith R. Ferguson, Special Assistant to the Attorney General, by Graydon S. Staring, and Lillick, Geary, McHose, Roethke & Myers appearing by Gordon K. Wright, and the Court having received arguments, both written and oral, and it appearing on the face of the Third Party Complaint that it does not state a claim against the United States of which this Court has jurisdiction, and good cause appearing therefor,

It is hereby ordered, adjudged and decreed that the Third Party Complaint of Coastwise Line, a corporation, against the United States of America, be, and hereby is, dismissed without leave to amend.

Dated this 28th day of January, 1957.

LEON R. YANKWICH,

*United States District Judge.*

## Appendix E

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OPINION IN MANGONE v. MOORE-MacCORMACK LINES v. AMERICAN STEVEDORES AND UNITED STATES, E.D. N.Y., CIVIL NO. 15,951.

The defendant, United States of America, moves for an order dismissing the third party complaint as to said defendant, pursuant to Rule 12-b (1) and (2) of the Federal Rules of Civil Procedure.

The question involved is whether the said defendant is properly joined as a third party defendant in a cause of action in admiralty, alleged in the third party complaint where the original complaint pertains to a civil jury claim.

The plaintiff, a longshoreman, in his original complaint against the shipowner, Moore-MacCormack Lines, Inc., alleged causes of action for negligence and unseaworthiness, basing jurisdiction of this court upon diversity of citizenship, 28 U.S.C.A. 1332.

Subsequently, the shipowner obtained leave to serve a third party complaint against the third party defendants, The United States of America, as time charterer of the vessel, S.S. Mormacmoon, and American Stevedores Co., Inc., the plaintiff's employer.

It is alleged in the third party complaint that the shipowner and the Government entered into a contract of time charter party for the transportation of military and government cargoes and that pursuant thereto the Government's agents installed a certain padeye for loading this cargo; that the Government engaged the stevedores to load the cargo; that the wrongful

installation of the padeye by the Government, and the negligent use thereof by the Government and/or the stevedores were the primary cause of the injuries alleged in the complaint in that the vessel was in a seaworthy condition when delivered to the Government or the stevedores pursuant to the time charter, and that the said equipment was so used without the knowledge or consent of the shipowner. It is further alleged that by the terms of the time charter the Government was obligated to the shipowner to perform its work in a proper manner; that under the contract between the Government and the stevedore, the latter was obliged to perform its work thereunder in a proper manner, which obligation inured to the benefit of the shipowner; that the stevedore also undertook with the shipowner itself, while performing its stevedoring work, to do so in a proper manner. Finally, it is alleged that jurisdiction herein is based on either the Suits in Admiralty Act, 46 U.S.C.A. 741 et seq., the Public Vessels Act, 46 U.S.C.A. 781 et seq., or the Federal Tort Claims Act, commonly called the Tucker Act, 28 U.S.C.A. 1346(b), 2671.

It is not alleged that any of the aforesaid agreements or contracts contain any express provisions for indemnity. If that were so, the third party action could be purely a contract action. See *Chicago, B. I. & Pac. R. Co. v. Dobry Flour Mills*, 10 Cir., 211 F. 2d 785; Compare *Chicago, R. I. & Pac. R. Co. v. United States*, 7 Cir., 220 F 2d 939.

The third party complaint, however, is based upon the aforesaid contracts, and thus the cause of action,

in this respect, is for breach of contract, although no specific provision of indemnification is included in the agreement. *Ryan Co. v. Pan-Atlantic Corp.*, 350 U.S. 124, at 133, 134.

Although in this latter respect the action is for tortious breach of contract, nevertheless the action is in contract. *Keifer & Keifer v. Reconstruction Finance Corp.*, 306 U.S. 381; *United States v. Huff*, 5 Cir., 165 F. 2d 720.

Thus, the District Court would have no jurisdiction under the Tucker Act for the said action, in contract, is in excess of \$10,000. *Hammond-Knowlton v. United States*, 2 Cir., 121 F. 2d 192, certiorari denied 314 U.S. 694.

The third party complaint also contains allegations upon which a claim for common law indemnity is based. It is often stated that such a claim is based upon implied contract or quasi-contract. However, it has been held that the "implied contract" referred to in the Tucker Act is a contract "implied in fact" and not a contract "implied in law", or quasi-contract. *G. F. Harms Co. v. Erie R. Co.*, 2 Cir., 167 F. 2d 562. *Cf. Ryan v. Pan Atlantic Corp.*, *supra*. It has been held that such actions for common law indemnity are tort claims under the Tucker Act. *Chicago, Rock Island & Pac. R. Co. v. United States*, *supra*, and cases cited.

On the other hand, whether in contract or tort, this third party action is maintainable in admiralty. A stevedoring contract is maritime, *American Steve-*



*dores v. Porello*, 330 U.S. 446; a charter agreement is maritime, *Matson Navigation Co. v. United States*, 284 U.S. 352; a common law claim for indemnity is likewise cognizable in admiralty. The No. 34, 2 Cir., 25 F. 2d 602, reversing petition of *L. Boyer's Son Co.*, 23 F. 2d 201, certiorari denied *T. Hogan & Sons, Inc. v. L. Boyer's Sons Co.*, 278 U.S. 606. Cf. *Canale v. American Export Lines*, 17 F.R.D. 269.

Both the Suits in Admiralty Act and the Public Vessels Act are to be construed together. *United States v. Caffey*, 2 Cir., 141 F. 2d 69. They are complementary jurisdictional statutes providing for admiralty suits against the United States. *Aliotti v. United States*, C.A. Cal. 221 F. 2d 598; *Phalen v. United States*, 2 Cir., 32 F. 2d 687; 46 U.S.C.A. 782.

Since the remedy sought by the third party complaint is one that may be maintained under one of these acts, jurisdiction is given under them to the exclusion of the Federal Tort Claims Act. *Prudential Steamship Corp. v. United States*, 2 Cir., 220 F. 2d 655; *Isbrandtsen Company v. United States*, 2 Cir., 233 F. 2d 184; *Johnson v. United States Shipping Board Emergency Fleet Corp.*, 280 U.S. 320; *Simonowycz v. United States*, D.C. Ohio, 125 F. Supp. 847.

Since the admiralty court would have jurisdiction, and since jurisdiction would be excluded on the civil side, the question remains whether the Federal Court can try the civil and admiralty actions together, or more particularly, whether the Court can at the same time sit as a court of law and a court of admiralty.

The decisions of Judge Dimock in *Cornell Steamboat Company v. United States*, S.D.N.Y., 138 F. Supp. 16, and *Dell v. American Export Lines*, S.D. N.Y., 142 F. Supp. 511, are followed rather than those of Judge Murphy in *Skupski v. Western Navigation Corp.*, S.D.N.Y., 113 F. Supp. 726, and Judge Kaufman in *Canale v. American Export Lines*, *supra*. See also *McKenna v. United States*, S.D.N.Y., 91 F. Supp. 556.

It has been held that a third party libel under the 56th Rule must be maritime in nature. *Soderburg v. Atlantic Lighterage Corp.*, 2 Cir., 19 F. 2d 286, certiorari denied 275 U.S. 542; *Benedict on Admiralty*, Vol. 2, 6th Ed., Sec. 350. It seems conversely that a third party complaint, under Rule 14 of the Federal Rules of Civil Procedure, should be civil in nature. In fact, Rule 81(a)(1) of the Federal Rules expressly provides that said rules do not apply in admiralty.

While there are some decisions permitting a joinder of jury and non-jury causes, the difficulties encountered therein are minimal by comparison to those in the case at bar. To combine these two jurisdictions together in one litigation seems improper and not feasible.

Under Civil Rule 14 a party may not be impleaded simply because it is or may be liable to the plaintiff, but only, since the 1946 amendment, upon the ground that it is liable to the impleading defendant; under Admiralty Rule 56 a party may be impleaded upon either ground. Cf. *Moore's Federal Practice*, 2nd Ed. Vol. 3, Secs. 14.20, 14.15, 14.16.

Under Civil Rule 14, the Government would not be liable unless the third party defendant satisfied the original judgment. *Canale v. American Export Lines*, S.D.N.Y., 1956 A.N.C. 1350 (not otherwise reported); *Thomas v. Naloo Refineries*, 10 Cir., 214 F. 2d 884; *Clinton v. Roehm*, 124 N.Y. Supp. 789, 139 App. Div. 73. Under Admiralty Rule 56 libelant is entitled to recover directly against an impleaded respondent for damages caused by the latter's negligence. When a person or vessel is impleaded under this rule, the case is treated as if the libel had originally been filed against it, and the decree may so provide. *The G. L. 40*, 2 Cir., 66 F. 2d 764; *Staples v. Manhattan Lighterage Corp.*, E.D.N.Y., 68 F. Supp. 754, affirmed 158 F. 2d 284.

The District Court must also consider whether the claim against the Government is maintained in rem or in personam, both of which are permitted by the Suits in Admiralty Act. *Grillea v. United States*, 2 Cir., 229 F. 2d 687 and 232 F. 2d 919.

Variations in pretrial procedure and evidence greatly augment the difficulties. A recent decision of the Court of Appeals of this Circuit in *Paduono v. Yamashita Kison Kabushiki Zaiaba*, 2 Cir., 221 F. 2d 615, demonstrates, quite clearly, the basic and historical differences between the civil and admiralty jurisdictions. To allow the admiralty jurisdiction, which is constitutional, to be so adulterated by civil diversity jurisdiction, which has come under severe criticism, would impair the usefulness of that ancient and historic tribunal. Cf. *Lumbermen's Mutual Casualty Co. v. Elbert*, 348 U. S. 48.

Finally, the Tucker Act expressly provides that remedies provided for by the Suits in Admiralty Act and the Public Vessels Act shall be excluded thereunder. 28 U.S.C.A. 2680(d).

Waiver of sovereign immunity should be strictly construed. United States v. Sherwood, 312 U. S. 584.

The motion is granted.

Walter Bruchhausen,

U. S. D. J.

## Appendix F

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[Title of Court and Cause.]

**THIRD PARTY COMPLAINT IN HIDICK v. ORION SHIPPING & TRADING COMPANY AND PACIFIC CARGO CARRIERS CORP. v. UNITED STATES, S.D. N.Y., CIVIL NO. 97-365.**

### **THIRD PARTY COMPLAINT OF THE DEFENDANT PACIFIC CARGO CARRIERS CORPORATION.**

1. Plaintiff, Massoad Abdaliam Hidick, has filed an amended complaint against the defendants, Orion Shipping & Trading Co., Inc. and Pacific Cargo Carriers Corporation. A copy of said amended complaint is attached hereto and marked Exhibit "X".

2. The defendant and third party plaintiff, Pacific Cargo Carriers Corporation, at all the times hereinafter mentioned, was and now is a corporation organized and existing under and by virtue of the laws of the State of New York, with an office and place of business at No. 80 Broad Street, in the County, City and State of New York, and was the owner of the S.S. SEACORONET.

3. The third party defendant, the United States of America, a corporate sovereign, was at all times hereinafter mentioned, through its Department of the Navy (Military Sea Transportation Service), the time charterer of the said S.S. SEACORONET, and has by statute permitted itself to be sued in relation thereto.

4. On or about the 22nd day of April, 1952, third party plaintiff and third party defendant entered into a written time charter party (MSTS Contract No.



1102) wherein and whereby third party plaintiff, as Owner, agreed to and did let, and third party defendant, as Charterer, agreed to and did hire the S.S. SEACORONET, upon the terms and conditions set forth in said time charter party and the extensions thereof are attached hereto and marked Exhibit "Y".

5. On or about August 17, 1953, while the aforesaid time charter was in force and effect, the S.S. SEACORONET was, pursuant to directions of the third party defendant, at the port of Pusan, Korea. At said time and place, the third party defendant was, pursuant to the terms of the aforesaid time charter, loading a cargo into the holds of the vessel. As part of the said cargo, gas cylinders said to be empty and free of gas, were being loaded onto the vessel by personnel engaged by and under the supervision and control of the said third party defendant.

6. At about 2300 hours on said date, one of the said gas cylinders loaded aboard the vessel was either defective or was otherwise damaged and was not empty and free of contents, but on the contrary contained harmful and poisonous gas and said gas was permitted by third party defendant, its agents, servants and/or employees, to escape and penetrate various compartments of the vessel, including among others, the crew quarters.

7. The said plaintiff Massoad Abdallan Hidick alleges in his amended complaint herein that while employed aboard the said vessel as a member of the crew and on or about August 17, 1953, he was caused to inhale noxious and poisonous fumes, as heretofore de-

scribed, as a result of which he sustained certain personal injuries. Plaintiff alleges that his injuries were caused by the negligence of the defendants and unseaworthiness of the vessel.

8. Under the terms and conditions of the aforesaid contract of charter party, the third party defendant was required to and did assume all responsibility for the loading and discharging of the S.S. SEACORONET and for the acts or failures to act of the persons engaged by it to accomplish the loading and discharging.

9. Third party plaintiff specifically denies that any negligence on its part or unseaworthiness of the vessel caused or contributed to the plaintiff's alleged injuries. If, however, it be found at the trial of this action that the plaintiff's injuries were caused by some condition for which it can be held liable, then and in that event, the third party plaintiff alleges that such condition resulted from the direct and primary negligence of the third party defendant, its agents, servants and/or employees and the failure of the third party defendant to perform the operation of loading the vessel in a reasonably safe manner which it was obligated to the third party plaintiff to do by the terms and conditions of the said time charter party.

10. By reason of the foregoing, if plaintiff recovers against the third party plaintiff, Pacific Cargo Carriers Corporation, on the ground of negligence in the loading of the S.S. SEACORONET or of unseaworthiness caused thereby, which said third party plaintiff denies occurred or existed, the third party

defendant, United States of America, is liable over to the third party plaintiff in indemnity for the amount of such recovery.

Wherefore, the defendant and third party plaintiff, Pacific Cargo Carriers Corporation, demands judgment against the third party defendant, United States of America, for all sums that may be adjudged against it in favor of the plaintiff, Massoad Abdallan Hidick.

Nelson, Healy, Baillie & Burke,

By Allan A. Baillie,

A Member of the Firm,

Attorneys for Defendant and

Third Party Plaintiff.

52 Wall Street, New York 5, New York.

(Attachments omitted.)



No. 15264

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**United States Court of Appeals**  
**For the Ninth Circuit**

---

ORION SHIPPING AND TRADING COMPANY, a Corporation,  
and PACIFIC CARGO CARRIERS CORPORATION,  
*Appellants,*

vs.

UNITED STATES OF AMERICA, *Appellee.*

---

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR  
THE WESTERN DISTRICT OF WASHINGTON,  
NORTHERN DIVISION

---

**REPLY BRIEF OF APPELLANTS**

---

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FILED

MAY 28 1957





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# United States Court of Appeals For the Ninth Circuit

ORION SHIPPING AND TRADING COMPANY, a Corporation, and PACIFIC CARGO CAR- RIERS CORPORATION,	<i>Appellants,</i>	} No. 15264
vs.		
UNITED STATES OF AMERICA,	<i>Appellee.</i>	

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR  
THE WESTERN DISTRICT OF WASHINGTON,  
NORTHERN DIVISION

## REPLY BRIEF OF APPELLANTS

### COMMENT ON APPELLEE'S COUNTER-STATEMENT OF THE CASE

While wholly immaterial to a discussion of the merits of the errors assigned by the appellant, the appellee insists on calling the Court's attention to a so-called "warning," given by Judge Lindberg in the early stages of the case in Cause Number 15261 in which the Government's motion for dismissal was initially granted. The appellee makes the following statement in its brief (page five):

"Actually, as early as December 6, 1954, in the companion case, No. 15,621, now consolidated with this case on appeal, Judge Lindberg granted the Government's motion and dismissed the third party complaint (R. 6). A motion to vacate the dismissal was subsequently granted, without opposition from the Government, in order that the case

could be transferred to Judge Bowen before whom the other six law cases were then pending.”

There was no opposition from the Government on the motion to vacate only for the reason that it was the inadvertence of Government counsel which resulted in the initial order being entered without argument. Also, the vacating of the dismissal was to correct this inadvertent error and a subsequent transfer to Judge Bowen was made as had been originally planned. The actual reasons for the entering of the order and subsequent vacation thereof are not revealed by the appellee but are included in this brief (See Appendices A and B).

Appellee also argues that the mere reservation by the trial court of the motion to dismiss until the time of trial would constitute a “warning” to the appellant. The appellant’s attorney, however, flatteringly referred to by the appellee as “experienced admiralty counsel,” knew from past experience with Judge Bowen that the reservation of pretrial motions until time of trial would not be indicative of the ultimate ruling on said motions.

Appellee refers to an “astonishing feature of this case” as being the filing of twelve separate cases against the United States arising out of the gassing incident. Appellee fails to advise this Court that three of the seamen brought simultaneous actions at law and in admiralty and that subsequently the three admiralty cases were dismissed. Of the remaining nine cases, two were instituted in New York by two seamen who, of course, had the right to select their own forum and in which forum

the defendant Orion similarly had the right to implead the United States of America. Thus it can hardly be said that the appellant has fostered a multiplicity of action, particularly when it is recalled that the appellant was the party who moved to consolidate the seven cases for trial.

All of the foregoing is immaterial to the merits of this cause but is set forth in answer to appellee's comment that the appellant "made improper use of third party procedure" (page 6), "stubbornly persisted in their vexatious course of multiple suits" (page 9), "intended to obscure the real nature of the action" (page 13), and "have harassed the United States with all of the several suits pointed out above and have, in the main, used third party procedure to accomplish this multiplicity of action" (page 33). The procedure followed by appellant was specifically intended to save time and expense in this multiple litigation.

### **COMMENT ON APPELLEE'S SUMMARY OF ARGUMENT**

It is interesting to note the appellee's repeated assertions that the procedural steps taken by the appellant have resulted in "needless multiplicity of actions" in view of what would happen in this case if the ruling of dismissal by the trial court of the third party claim is permitted to stand. Appellee has already set forth in its brief (Appendix B) the libel pending in the Southern District of New York against the United States for the total sum of the judgments entered on behalf of the plaintiffs in these seven consolidated causes. Thus, in New York, the entire case on the merits would

have to be retried. The New York Judge would be required to listen to the identical extensive testimony with reference to the alleged negligence of the Government and lack of negligence of the appellant, Orion, as that heard by Judge Bowen. In the alternative, if this case is remanded to Judge Bowen with instructions to proceed to a decision on the third party cause of action against the appellee, no further testimony will need be presented since Judge Bowen has heard the entire cause against the Government and is in a position, *at this time*, to rule on the merits of the claim for recovery over. Such further proceedings would require only argument of counsel on the evidence already heard by the trial court together with its oral or written opinion thereon. It is to be recalled that Government counsel participated fully in all phases of the trial below, including both the personal injury actions and the third party proceedings. This can hardly be described as a "multiplicity of actions" when compared to the alternative necessary of re-trying the entire case in the New York court. The mere fact that seamen Wilson and Hiddick have started actions against Orion in New York followed by the third party impleading of the United States of America is of no moment to this court in determining that the most legally justifiable and expeditious step at this time would be to direct Judge Bowen to re-assume jurisdiction of the third party case already heard by him.

Generally on multiplicity of actions, the Tenth Circuit has held as follows in *United States v. Accord*, 209 F.(2d) 709 (Cert. den. 98 L.ed. 1115):

"Rule 14 was derived from Admiralty Rule 56.



See 28 U.S.C.A., Rules, p. 119. Rule 14 was formulated and adopted in keeping with the purpose of the Federal Rules of Civil Procedure to simplify and expedite procedure. The purpose of Rule 14 was to accomplish in one proceeding the adjudication of the rights of all persons concerned in the controversy and to prevent the necessity of trying several related claims in different lawsuits. The rule should be liberally construed to effectuate its intended purposes."

On the availability of *third party procedure* to facilitate the trial of multiple claims, the United States Supreme Court has stated in *United States v. Yellow Cab Co.*, 340 U.S. 543, 71 S.Ct. 399, 406, 95 L.ed. 523:

"Once we have concluded that the Federal Tort Claims Act covers an action for contribution due a tortfeasor, we should not, by refinement of construction, limit that consent to cases where the procedure is by separate action and deny it where the same relief is sought in a third-party action.

\* \* \*

"The Government suggests that difficult procedural problems may arise in other cases if a waiver of immunity is held to exist in these cases. For example, the Act requires claims against the United States to be tried without a jury and, although a jury was not insisted upon in the instant cases, the Seventh Amendment to the Constitution preserved to private individuals their right of trial by jury on such claims in a federal court. The Government argues that the Act is not sufficiently specific to permit two such different modes of trial to arise in the same case.

"Such difficulties are not insurmountable. If, for example, a jury had been demanded in the Yellow



Cab case, the decision of jury and non-jury issues could have been handled in a manner comparable to that used when issues of law are tried to a jury and issues of an equitable nature in the same case are tried by the court alone. If special circumstances had demonstrated the inadvisability, in the first instance, of impleading the United States as a third-party defendant, the leave of court required by Rule 14 could have been denied. If, at a later stage, the situation had called for a separation of the claims, the court could have ordered their separate trial. Fed. Rules Civ. Proc. 42 (b). The availability of third-party procedure is intended to facilitate, not to preclude, the trial of multiple claims which otherwise would be triable only in separate proceedings. The possibility of such procedural difficulties is not sufficient ground for so limiting the scope of the Act as to preclude its application to all cases of contribution or even to all cases of contribution or even to all cases of contribution arising under third-party practice. If the Act develops unanticipated complications, Congress can then meet them to such extent as it may desire to fit the demonstrated needs."

### COMMENT ON APPELLEE'S ARGUMENTS ON JURISDICTION

Without providing a single citation in support thereof, appellee makes the bald statement that the doctrine of ancillary jurisdiction, urged by the appellant, applies only to suits where it is required by the Court's custody of property or assets which are the subject of the various claims. Counsel for appellee obviously failed to read *United States v. Acord, et al., supra*, cited by appellant in its brief. That case involved a cause of

action for damages against a railroad under the Federal Employers Liability Act in which the United States was an impleaded third party under the Federal Torts Act. Nowhere in the case does there appear the presence of any "property or assets in the custody of the Court" and the holding by the Tenth Circuit on this doctrine is as follows (p. 712) :

"It has been held that a proceeding on a third-party plaintiff's claim under Rule 14 is an ancillary proceeding incidental to the main action and that no separate ground of jurisdiction is required."

The Court will recall that in our opening brief we noted that the foregoing statement was supported by cases from the Second and Tenth Circuits and from 14 District Courts. In view of appellee's completely unsupported statement that the doctrine is applicable only to cases wherein property or assets are in the custody of the Court, we have very carefully reviewed these 16 footnote cases and find that they include 9 cases for personal injury, 3 cases for death, 2 on contract, 1 on S.E.C. violations, 1 on patent infringement and 1 on a claim for stock assessment. We further find that *none* of the foregoing cases involved property or assets in the custody of the Court and that all supported the general rule on ancillary jurisdiction quoted above in the *Acord* case.

The appellee refers to the case of *Higa v. Transocean Airlines*, 230 F.(2d) 780, 1956 A.M.C. 122 (9 Cir. 1955). That case is not strictly applicable since it interprets the Death on the High Seas Act, the pertinent portion of which act, reads as follows :

“ \* \* \* the personal representatives of the decedent may maintain a suit for damages in the district courts of the United States, *in Admiralty*,” (Emphasis added)

It is of particular interest to note in that case that on a petition for re-hearing the appellant raised for the first time the question of whether the case should have been dismissed by the District Court or transferred to its admiralty docket. This Court refused to consider that phase of the matter only because the appellant was belatedly attempting to enlarge the scope of her appeal in a petition for re-hearing. However, this court in a footnote, referred to earlier 9th Circuit cases on the procedure of transferring from law to the admiralty docket as follows:

“This court may so remand an appropriate case. See *Twin Harbor Stevedoring & Tug Company v. Marshall*, 9 Cir. 1939, 103 F.(2d) 513; *Kobilkin v. Pillsbury*, 9 Cir., 1939, 103 F.(2d) 667.”

In the *Twin Harbor* case, *supra*, this Court, in a suit to set aside an award of the deputy commissioner under the Longshoremen's and Harbor Workers' Act found that the appellants had filed their bill as a complaint at law rather than as a libel on the admiralty side of the District Court. In considering this fact and in making appropriate disposition thereof this Court stated:

“Appellants should have filed their bill as a libel on the admiralty side of the District Court. *Crowell v. Benson*, 285 U.S. 22, 37, 49, 52 S.Ct. 285, 76 L.ed. 598. We have considered the merits for the guidance of the court below, as if we were reversing a case at law for an erroneous instruction, and nev-

ertheless passing on questions of evidence certain to arise in a new trial. The cause is remanded with instructions to treat the bill as a libel, the motion to dismiss as an exception to its sufficiency (Admiralty Rule Rup. Ct. 27, 28 U.S.C.A. following section 723), and to enter a decree of dismissal.

“The decree is vacated, *with instructions to transfer to Admiralty docket* and decree a dismissal.” (Emphasis added)

An almost identical disposition was made in the *Koblikin* case, *supra*.

Appellee refers to the decision of Judge Mathes of the Southern District of California in *Kunkel v. United States*, 140 F.Supp. 591, 595, 1956 A.M.C. 1195, 1199 (S.D. Cal.), to demonstrate the inherent difference between law and admiralty. In that case the widow of the deceased sought recovery against the Government under the Death on the High Seas Act. The action was brought at law and the Government moved to dismiss on the ground that the Death on the High Seas Act required the institution of suit on the admiralty side. But for one circumstance in the case, Judge Mathes would have transferred this matter to the admiralty docket. He stated as follows (p. 594):

“Also to be noted is the circumstance that causes of action on such claims are given by the Act to ‘the personal representative of the decedent’ alone. For were it not for the fact that here the widow, too, is joined in her personal capacity as party plaintiff, it would be a simple matter to transfer this case to the admiralty docket. *Cf. Higa v. Transocean Airlines, supra*, on rehearing, 230 F. (2d) 786; *Koblikin v. Pillsbury*, 9 Cir., 1939, 103



F.(2d) 667-671, affirmed, 1940, 309 U.S. 619, 60 S.Ct. 465, 84 L.Ed. 983.”

Thus Judge Mathes, save for the dual status of the widow in the suit, would have transferred the case to the admiralty docket just as the trial court here should have done and adjudicated the third-party claim.

Appellee apparently feels aggrieved that the cause of action against it was not tried under admiralty rules of procedure. It is to be noted, however, that it was very clearly determined at the outset of the case that the court and all parties agreed that insofar as any evidence was produced reflecting on the claimed liability of the United States, said evidence would be considered by the court as the trier of the fact and not by the jury. *See Transcript pages 50-54.* Following this procedure, opening statements on the third-party cause of action were made in the absence of the jury (Tr. 54) and so likewise were the arguments on that cause of action heard in the absence of the jury at the termination of the case (See Tr. 56). Appellee cites no prejudice whatsoever resulting from this procedure. In fact it is a common occurrence that courts concurrently try cases at law with juries, reserving admiralty phases of the case for their own determination (such as the joinder of claims for negligence, unseaworthiness and maintenance — appellant’s brief, p. 6). While the appellee states that “it is clear” from the language of the trial court that he understood the problem was one of jurisdiction and lack thereof, it is equally clear that no such inference can fairly be drawn from reading of the entire recovery over proceedings (Tr. 56) and the court’s oral opinion on the motion to transfer (Tr. 97). The



recovery over proceedings involved only the question of venue and the court ruled thereon and dismissed the cause for lack of venue. It is for this reason that the appellant included in its specification of assigned errors (appellant's brief, page 11) only reference to the question of venue.

However, that the District Court had jurisdiction of this matter is treated extensively at pages 2-6 of appellant's brief. Merely by raising the question of jurisdiction in its answering brief, as it has a right to do, does not permit or justify the appellee in incorrectly stating that the trial court dismissed for lack of jurisdiction. In fact the trial court stated (Tr. 78):

“In my opinion the court has jurisdiction of this third party over action against the United States.”

The court at no time reversed its opinion on this aspect of the case and its eventual dismissal was solely on the ground of the lack of proof and allegation of venue. The order of dismissal entered on July 26, 1956 (Tr. 34) while merely reciting that the third party action is exclusively under the Suits in Admiralty Act (with which the appellant has no disagreement) states that the action is being dismissed only because of failure to prove proper venue under that Act.

Appellee further misconstrues the grounds for the trial court's dismissal by referring to another case considered by Judge Bowen, *Ostrom v. Weyerhaeuser Steamship Company*, W.D. Wash., Civil No. 4255 (Feb. 20, 1957). That case was materially different, however, since there, a determination was obtained early in the matter by the Government's objection to being im-

pleaded in a case in which the third party complaint alleged neither the presence of the vessel nor of the cargo in the jurisdiction of the court. Since the motion was presented to the court without supporting affidavits and without the amendment to the third party complaint to set forth the presence of the vessel or its cargo, the court rightfully, in an early stage of the proceedings, denied the motion to bring in the United States as a third party defendant. The instant case, in contra-distinction, is one in which the Government's motion was reserved until after the trial and in which trial proof of venue was offered and a request was made to amend the pleadings accordingly to supplant the lack of the allegation of venue.

The case of the *United States v. Finn*, 239 F.(2d) 679 (9 Cir., 1956) cited by appellee, is wholly inappropriate. While holding that the United States had not given consent to a counter-claim being made against it, that case did not, however, involve the presence or absence of the proper venue or the necessity of an allegation thereof.

### **COMMENTS ON APPELLEE'S ARGUMENT ON VENUE**

A careful re-analysis of the applicable provision of the Suits in Admiralty Act, 46 U.S.C.A. 742, is necessary to answer and dispose of the appellee's continued contention that the presence or absence of the SEACORONET in the jurisdiction of the court during the pendency of the action was irrelevant and immaterial.

Initially, to determine the appellant's rights against the Government under the Suits in Admiralty Act, the

accident or occurrence in this case must be considered as though a private individual rather than the Government had been involved. If such had been the case, it is clear that a proceeding could have been brought in Admiralty against the vessel *in rem*, against the cargo *in rem* or against the owner *in personam*. Since this is true, the applicability of the Act is established. Beyond this point, however, the Act has set forth certain procedural steps which must be met. The Act provides three possibilities of venue for the filing of the "libel in personam" permitted by this section. Of these three alternatives, the first need not be considered since it was not established that the suing party was a resident or had an official place of business in the jurisdiction of the lower court. The alternative as to the place where the cargo is found need not be considered since there was no proof of the presence of the cargo. The "suing party" here, however, has established or offered to establish the third alternative, namely, that the vessel was within the jurisdiction during the pendency of the action. Nowhere in the Act is it stated, as contended by appellee, that the two alternatives regarding the vessel and the cargo may be used only in the case of *in rem* claims. The Act has merely permitted a libel in personam but as a prerequisite has required that one of the three alternatives exist. While section 743 of the Act permits an election to proceed on *in rem* principles, there is still permitted only the filing of a libel in personam and no distinction is made between the three alternative prerequisites of venue.

To summarize and clarify this analysis of the Act

in relation to this case, the following is found to be true:

- (1) The third party complaint proceeded *in personam* and made no election to proceed under *in rem* principles.
- (2) The Act sets forth three alternative prerequisites of venue without distinguishing between *in personam* proceedings and proceedings on *in rem* principles.
- (3) Of the three alternatives, the appellant established the presence of the vessel.
- (4) The evidence on the presence of the vessel was sufficient to establish venue but for the trial court's error in refusing to permit the pleadings to conform to the proof and in sustaining the objection to the offer of proof as to the presence of the vessel.

### CONCLUSION

The error of the trial court in ruling as it did on venue and on the motion to transfer results in multiplicity of litigation which sound judicial procedure consistently attempts to prevent. The procedure followed by the appellant was specifically designed to prevent such multiplicity.

As quoted by the Supreme Court in *United States v. Yellow Cab Company case, supra*, Judge Cardozo stated in *Anderson v. John L. Hayes Construction Company*, 243 N.Y. 140, 147, 153 N.E. 28:

“No sensible reason can be imagined why the State, having consented to be sued, should thus paralyze the remedy.”

The fundamental distinctions between law and ad-

miralty are not dissipated nor obliterated by a judge and a jury hearing testimony simultaneously from witnesses, with the former applying said testimony to a claim before it for recovery over under a Suits in Admiralty claim, and the latter applying the testimony to a negligence claim under the Jones Act, which it is trying.

The Government participated fully in the trial below and was as able to produce evidence on all phases of this litigation on its own behalf in the Western District of Washington as in any other District Court in the country.

Procedural refinements, such as contended for by appellee are inconsistent with present-day trends designed to provide speedy and adequate justice to all parties involved.

For the above reasons, the appellant respectfully requests that this court reverse the rulings of the trial court.

Respectfully submitted,

BOGLE, BOGLE & GATES

ROBERT V. HOLLAND

*Attorneys for Appellants.*





## **APPENDICES**



CHARLES E. AREGOOD, *Plaintiff,*  
vs.  
ORION SHIPPING & TRADING COMPANY, a  
corporation.  
*Defendant and Third Party Plaintiff,*  
vs.  
UNITED STATES OF AMERICA,  
*Third Party Defendant.*

No. 3623

COMES NOW the defendant and third party plaintiff herein and moves this Honorable Court for the entry of an order vacating that certain order entered by minute entry on December 6, 1954 granting third party defendant's motion to dismiss third party complaint under Rule 12 (d).

This motion is based upon the file herein and upon the attached affidavit of Robert V. Holland.

BOGLE, BOGLE & GATES  
*Attorneys for Defendant and  
Third Party Plaintiff, Orion  
Shipping & Trading Co., Inc.,  
a corporation.*

STATE OF WASHINGTON }  
COUNTY OF KING } ss

ROBERT V. HOLLAND, being first duly sworn on oath, deposes and says: That he is one of the attorneys for the defendant and third party plaintiff herein and makes this affidavit in support of the defendant's motion to vacate the order entered on December 6, 1954 dismissing the third party complaint;

That on October 4, 1954 the following captioned pleadings were served upon your affiant:

1. Motion to dismiss third party complaint under Rule 12 (d) Federal Rules of Civil Procedure.
2. Third party defendant's memorandum of points and authorities in support of motion to dismiss third party complaint.

That on November 30, 1954 a "Notice of Motion" was served upon your affiant setting down the third party defendant's motion to dismiss for hearing; that said notice of motion contained only the following indication of the time for said motion "on the 2nd day of \_\_\_\_\_, 1954 at 10:00 A.M."

That your affiant however in telephone conversation with Mr. Frank Cushman, Assistant United States Attorney, was advised that the motion was coming on regularly for hearing on the 6th day of December, 1954; that your affiant was also advised on that date that an identical motion in cause No. 3728 was to come on for hearing before the Honorable John C. Bowen.

That your affiant advised Mr. Cushman that he was engaged in a trial of a case in Superior Court on said date and that he requested that the matters be continued



in both courts; that Mr. Cushman advised your affiant that an Assistant United States Attorney from San Francisco was present in town for the purpose of arguing the motions among other matters but that he was agreeable to continuing the motions to a later date or striking them from the motion calendar; that Mr. Cushman agreed that he would so dispose of the matters including the motion pending in the above entitled cause.

That pursuant to said agreement your affiant was advised by Mr. Cushman that the matter in the Honorable John C. Bowen's court had been continued and/or stricken but that your affiant was advised that apparently before the Assistant United States Attorney Leonard Ware was able to continue the motion in the above entitled court, the Honorable William C. Lindberg stated that he had studied the memorandum of authorities prepared by the United States Attorney's office, that he was prepared to rule on said motion and that he thereupon did rule upon said motion, granting the motion of the United States to dismiss the third party complaint. That your affiant had intended, at the appropriate and convenient time, to submit an extensive memorandum of authorities in opposition to the Government's motion; that your affiant desired and still desires to argue the matter at length before this Honorable Court; and that for the furtherance of justice and the interests of the parties your affiant requests this Honorable Court that the order of dismissal as to the third party defendant United States of

America be vacated with leave to the parties to argue the matter on the regular motion calendar.

ROBERT V. HOLLAND

Subscribed and sworn to before me this 29th day of December, 1954.

EDW. S. FRANKLIN

Notary Public in and for the State  
of Washington, residing at Seattle.

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
NORTHERN DIVISION

CHARLES E. AREGOOD, *Plaintiff,*  
vs.  
ORION SHIPPING & TRADING COMPANY, a  
corporation.  
*Defendant and Third Party Plaintiff,*  
vs.  
UNITED STATES OF AMERICA,  
*Third Party Defendant.*

No. 3623

The petition of the defendant, Orion Shipping & Trading Company, to vacate the order granting the third party defendant's motion to dismiss the third party complaint having come on regularly for hearing on the third day of January, 1955 and the defendant and third party plaintiff being represented by Bogle, Bogle & Gates and Robert V. Holland and the third party defendant, United States of America being represented by Assistant United States Attorney Frank N. Cushman and the court being advised that counsel for plaintiff did not desire to contest the petition, and the court having heard argument of counsel and being fully advised in the premises; now, therefore, hereby orders, adjudges and decrees:

That the defendant's petition to vacate the order granting third party defendant's motion to dismiss the third party complaint be and the same hereby is granted and that the minute entry of December 6, 1954 granting said motion to dismiss is hereby vacated.

Done in Open Court this 7th day of January, 1955.

W. C. LINDBERG  
U.S. District Judge.

Presented and approved by:  
ROBERT V. HOLLAND  
Of Bogle, Bogle & Gates  
Attorneys for Defendant and  
Third Party Plaintiff

Approved:

---

Attorneys for Plaintiff

CHARLES P. MORIARITY

FRANK CUSHMAN

Attorneys for 3rd Party Defendant

No. 15269

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United States  
Court of Appeals  
for the Ninth Circuit

---

UNITED STATES OF AMERICA,

Appellant,

VS.

F. C. HATHAWAY,

Appellee.

---

Transcript of Record

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Appeal from the United States District Court for the  
District of Oregon

FILED

NOV - 9 1956





No. 15269

---

United States  
Court of Appeals  
for the Ninth Circuit

---

UNITED STATES OF AMERICA,

Appellant,

vs.

F. C. HATHAWAY,

Appellee.

---

Transcript of Record

---

Appeal from the United States District Court for the  
District of Oregon

# THE

AMERICAN  
REPUBLICAN  
PARTY

OF THE

STATE

OF

NEW YORK

—

AND THE  
REPUBLICAN PARTY

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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## NAMES AND ADDRESSES OF ATTORNEYS

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VICTOR E. HARR,

Assistant United States Attorney,

United States Court House,

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MELVIN RICHTER, and

BERNARD CEDARBAUM,

Attorneys, Dept. of Justice, Washington, D.C.,

For Appellant.

WALTER J. COSGRAVE,

Pittock Block,

Portland, Oregon,

Attorney for Appellee.



In the United States District Court  
for the District of Oregon

Civil No. 7443

F. C. HATHAWAY,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

I.

This suit arises out of a contract between the plaintiff and the defendant and the amount of claim does not exceed \$10,000.

II.

On or about the 20th day of March, 1952, plaintiff and defendant entered into a contract No. DA-(S)-35-026-eng-12 for the sale of lock gates located at the old government locks, Cascade Locks, Oregon.

III.

On or about the 31st day of October, 1952, said contract was modified.

IV.

The plaintiff has been at all times ready and willing to perform said contract, as modified.

V.

Defendant has refused to perform said contract and has purported to terminate plaintiff's rights thereunder.

## VI.

By reason of defendant's breach of said contract, plaintiff has been damaged in the sum of \$14,500.00.

For a Second Cause of Suit, Plaintiff Alleges as Follows:

## I.

On or about the 20th day of March, 1952, plaintiff and defendant entered into a contract No. DA-(S)-35-eng-12 for the sale of lock gates located at the old government locks, Cascade Locks, Oregon.

## II.

On or about the 31st day of October, 1952, said contract was modified.

## III.

Because of reasons beyond the control of plaintiff, it was impossible for plaintiff to remove one-half of the steel covered by said contract.

## IV.

Plaintiff and defendant were mutually mistaken as to the conditions existing at the site of Cascade Locks at the time said contract was entered into.

## V.

By reason of the mutual mistake of the parties and the impossibility of removing more than one-half of the steel covered by said contract, said contract should be reformed by reducing the contract price by one-half.

Wherefore, plaintiff demands:

(1) That said contract be reformed to provide for a purchase price of \$3,750.00.

(2) That plaintiff have judgment against the defendant for the sum of \$10,000.

(3) That plaintiff have judgment against the defendant for costs.

/s/ WALTER J. COSGRAVE,  
Of Attorneys for Plaintiff.

[Endorsed]: Filed April 7, 1954.

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[Title of District Court and Cause.]

### ANSWER OF THE UNITED STATES

Comes now defendant United States of America, by and through C. E. Luckey, United States Attorney for the District of Oregon, and Victor E. Harr, Assistant United States Attorney, by direction of the Attorney General of the United States, and for answer to plaintiff's first cause of action herein, admits, denies and alleges as follows:

1. Admits the allegations of Paragraphs I, II and III.

2. Denies the allegations of Paragraph IV.

3. Denies the allegations of Paragraph V, except defendant admits that plaintiff's right to proceed under his contract was terminated by reason of his unilateral and inexcusable default.



4. Denies the allegations of Paragraph VI and the whole thereof and specifically denies that defendant breached said contract, and further specifically denies that plaintiff was damaged in the sum of \$14,500.00 or in any other amount.

For Answer to Plaintiff's Second Cause of Action,  
Defendant Admits, Denies and Alleges as Follows:

1. Admits the allegations of Paragraphs I and II.

2. Denies the allegations contained in Paragraphs III and IV.

3. Denies the allegations of Paragraph V and particularly denies that there was a mutual mistake of the parties; denies further that it was impossible to remove more than  $\frac{1}{2}$  of the steel, covered by said contract; and further denies that the contract should be reformed by reducing the contract price by  $\frac{1}{2}$  or any other percentage.

#### First Further and Affirmative Defense

The complaint does not properly state a claim upon which relief can be granted.

#### Second Further and Affirmative Defense

The Court has no jurisdiction of this claim, as alleged.

#### Third Further and Affirmative Defense

The plaintiff has failed to pursue his administrative remedies for relief and therefore the acts complained of are not actionable under statute or at all.

#### Fourth Further and Affirmative Defense

Defendant and all its agencies and employees exercised due care in all matters referred to in the complaint.

#### Fifth Further and Affirmative Defense

All damage, loss or injury described in the complaint was caused, if at all, by the voluntary and unilateral action of the plaintiff.

#### Sixth Further and Affirmative Defense

Defendant denies each allegation of fault or wrongful conduct set forth in the complaint or otherwise, and alleges that if plaintiff suffered any damage, loss or injury, such loss, damage or injury was due solely to plaintiff's own negligence, mistakes and lack of good judgment in failing to inform himself of the nature of the operations which he was about to undertake, and in failing to diligently perform his contractual obligations, and specifically, in failing to pay for and remove the steel purchased from defendant, as per his contract, prior to December 1, 1952, or subsequent thereto.

#### Seventh Further and Affirmative Defense

No act or failure to act of defendant or any employee of defendant was the proximate cause of any damage, loss or injury, if any, to plaintiff.

#### Eighth Further and Affirmative Defense

The defendant's liability if any, is contractually limited by Paragraph 11 of the General Conditions of the plaintiff's contract, which reads as follows:

“11. Limitation on Government liability. In any case where liability of the Government to the Purchaser has been established, the extreme measure of the Government’s liability shall not, in any event, exceed refund of the purchase price or such portion thereof as the Government may have received.”

By way of counterclaim, defendant United States of America alleges as follows:

1. On or about March 20, 1952, plaintiff, F. C. Hathaway, and defendant, United States of America, by and through its Contracting Officer of the Portland District, Corps of Engineers, U. S. Army, entered into Contract for sale of the government-owned lock gates at Cascade Locks, Oregon, on an “as is—where is” basis.

2. Plaintiff, as successful bidder was to pay the sum of \$7,500 for said government property prior to its removal from the government premises and to accomplish same prior to December 1, 1952.

3. To date, plaintiff has paid only the initial payment of \$1,500 to the government defendant.

4. Although the plaintiff’s contract performance time, without consideration from plaintiff, was informally allowed to extend to January 4, 1954, he only succeeded in removing approximately  $\frac{1}{2}$  of the salvageable material by said date and his right to proceed further was terminated by this default by the government at that time.

5. The defendant, as seller of its property, made no representations, no warranties, express or implied, or in no way misdirected or misinformed the plaintiff purchaser as to the difficulties of removal of the property, and, in fact, the government stands ready today to pass title to the remaining property upon full payment of the contract price by plaintiff in fulfillment of the contract terms.

6. The government has not prevented the plaintiff purchaser from performing in any way, nor has the government breached its contractual responsibilities at all.

7. By reason of plaintiff purchaser's default the government was compelled to sell the lock gates already removed by plaintiff to the highest bidder for the sum of \$4,387.98. This left a deficit balance due and owing from the plaintiff of \$1,612.02 for which demand was made. No effort has been made by plaintiff to pay this contractual obligation.

8. The defendant, United States of America, is entitled to its balance due and owing from the plaintiff in the amount of \$1,612.02.

Wherefore, defendant United States of America prays:

1. That plaintiff take nothing by his actions or either of them;

2. That the defendant, United States of America, be awarded its damages under contract in the amount of \$1,612.02; and

3. That the Court award to defendant its costs in this action and such further relief as the Court may deem proper.

C. E. LUCKEY,  
United States Attorney for  
the District of Oregon.

/s/ VICTOR E. HARR,  
Assistant U. S. Attorney.

Affidavit of service by mail attached.

[Endorsed]: Filed September 16, 1954.

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In the United States District Court  
for the District of Oregon

Civil No. 7443

F. C. HATHAWAY,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

### REPLY

Comes now the plaintiff and for reply to defendant's counterclaim herein, denies each and every allegation, thing and matter in said Counterclaim contained, except insofar as said counterclaim admits the allegations of plaintiff's complaint on file herein.

Wherefore, having fully replied, plaintiff prays



that defendant take nothing by his counterclaim and that plaintiff have judgment as prayed for in his complaint herein.

/s/ WALTER J. COSGRAVE,  
Of Attorneys for Plaintiff.

Service of copy acknowledged.

[Endorsed]: Filed September 21, 1954.

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[Title of District Court and Cause.]

### PRETRIAL ORDER

Before the Honorable Gus J. Solomon, Judge.

Appearances:

WALTER J. COSGRAVE,  
Attorney for Plaintiff.

VICTOR E. HARR,  
Assistant United States Attorney, Attorney  
for defendant.

### Nature of Proceedings

This is an action by plaintiff under § 1346, Title 28 USCA (Tucker Act) to recover from the United States damages for a breach of contract between plaintiff and the United States. Plaintiff also seeks reformation of the contract with respect to the contract price of the steel locks which were the subject of the contract.

The defendant in this proceeding denies its in-

debtedness to plaintiff in any amount, denies plaintiff is entitled to reformation of the contract, and by way of counterclaim, seeks judgment against plaintiff for damages for unpaid balance due on the aforesaid contract.

### Agreed Facts

1. This suit arises out of a contract between the plaintiff and the defendant and the amount of the claim does not exceed \$10,000.

2. On or about the 20th day of March, 1952, plaintiff and defendant entered into a contract numbered DA-(S)-35-026-eng-12 for the sale of certain steel lock gates located at the old Government locks, Cascade Locks, Oregon, which locks were below the level of the waters of the lake formed by Bonneville Dam.

3. Under the contract plaintiff agreed to buy and defendant agreed to sell approximately 985.3 gross tons of steel contained in 4 sets of lock gates for a price of \$7,500, \$1,500 of which was paid as a bid deposit and the balance of which was required to be paid prior to December 1, 1952, or prior to the removal of any property. Plaintiff made no further cash payments to defendant.

4. That in the fall of 1953, plaintiff removed from the water a part of the property to be salvaged under this contract of the approximate weight of 517 tons which was placed by plaintiff on the banks of the old lock canal at Cascade Locks, Oregon. On February 3, 1954, defendant extended invi-

tations to bid upon the aforesaid 517 tons of steel, and thereafter sold said steel for the sum of \$4,387.98.

5. That defendant on March 12, 1954, notified plaintiff that it was crediting to plaintiff the amount received on the aforesaid bid, to wit: \$4,387.98.

### Plaintiff's Contentions

1. On October 31, 1952, the parties modified the contract to permit removal of the salvaged property from the government premises directly to the contractor's points of sale in Portland, Oregon, subject to the condition that the government should be furnished certified scale weight of each load removed and should receive upon delivery to the contractor's point of sale the full amount received for each such load; such procedure was to continue until the government had received full payment under the contract, after which title to the remaining scrap would vest in the contractor.

2. The government refused to recognize as effective the modification of October 31, 1952.

3. The government refused to allow the removal of any portion of the salvage steel until the full contract price was paid and threatened to prevent such removal by force.

4. The defendant extended the time for completion of the contract to January 4, 1954, and on that date arbitrarily purported to terminate all of plaintiff's rights under the contract.

5. Time for payment of the purchase price and removal of the steel was extended by defendant to January 4, 1954.

6. The government claims to have terminated all rights of the contractor as of January 4, 1954, for nonpayment of the full purchase price.

7. The parties were equally mistaken as to the amount of steel which it was practically possible to remove from the old Cascade Locks.

8. Only one-half of the amount of steel which the parties contemplated would be removed was physically possible of removal.

9. The contract should be reformed by reducing the purchase price to one-half or \$3,750.

10. If defendant had allowed plaintiff to remove the steel as salvaged in accordance with the modification of October 31, 1952, said steel could have been sold at prices which would have brought to plaintiff a total of \$14,500.

11. By reason of the government's wrongful refusal to allow the removal of the steel in accordance with the modification and their threat of force to prevent such removal, plaintiff was damaged in the sum of \$14,500.

#### Defendant's Contentions

1. Answering Plaintiff's Contention No. 1, defendant admits that its contracting officer executed what purported to be a modification of the contract herein, but the defendant affirmatively contends that

said modification was ineffectual, and further that said purported modification was invalid since there was no consideration or benefit passed to defendant in support thereof; defendant further contends that said modification, if valid, did not change in any way any of the remaining terms, covenants and conditions of said contract, and in particular did not change the date within which plaintiff was to have performed under said contract.

2. Answering Plaintiff's Contention No. 2, defendant admits that it did not consider said purported modification as having been valid as is hereinbefore set forth.

3. Denies Plaintiff's Contention No. 3.

4. Denies Plaintiff's Contention No. 4 in that defendant asserts that it extended to plaintiff no express extension of time herein, but did, in effect, by sufferance, waive time of completion of said contract up to January 4, 1954, and did, by registered letter dated December 15, 1953, advise plaintiff that he was being given until January 4, 1954, to meet his contractual obligations, and, failing to do so, all his rights under the within contract would terminate on January 4, 1954; that plaintiff did not fulfill the terms of said contract and defendant did, on January 4, 1954, terminate said contract for nonpayment and nonperformance.

5. In answer to Plaintiff's Contention No. 5, defendant, by this reference, incorporates all of the affirmative contentions set forth in its Contention No. 4 aforesaid.



6. Admits Plaintiff's Contention No. 6 and further realleges and incorporates herein, all of the affirmative allegations contained in its Contention No. 4 aforesaid.

7. Answering Plaintiff's Contention No. 7, defendant contends that the contracting parties herein, among other things, agreed as follows:

That "all property listed herein is offered for sale 'as is,' and 'where is,' and without recourse against the government \* \* \* The description is based on the best available information, but the government makes no guarantee, warranty, or representation, express or implied, as to the quantity, kind, character, quality, weight, size, or description of any of the property or its fitness for any use or purpose, and no claim will be considered for allowance or adjustment or for rescission of the sale based upon failure of the property to correspond with the standard expected \* \* \*"

and the parties further agreed that the bidders, including plaintiff, were invited and urged to inspect the property to be sold herein prior to the submitting of bids, and by reason of aforesaid, defendant contends that Plaintiff's Contention No. 7 is not and cannot be material to the issues of this case. Should the court determine that Plaintiff's Contention is an issue in this case, then defendant denies Plaintiff's Contention No. 7 and the whole thereof.

8. Defendant contends that Plaintiff's Contention

tion No. 8 is not material to the issues of this case, by reason of the affirmative allegations set forth by defendant in its Contention No. 7, which, by this reference, is made a part hereof. Should the court determine that this contention is material to the issues of this case, then defendant denies said contention and the whole thereof.

9. Answering Plaintiff's Contention No. 9, defendant asserts that plaintiff has failed to allege any fact upon which relief prayed for can be granted, and, therefore, denies this contention and the whole thereof, and, further, in answer to this contention, defendant by this reference realleges all of the affirmative allegations set forth in its Contention No. 7 herein.

10. Answering Plaintiff's Contention No. 10, defendant denies that on October 31, 1952, it modified the contract herein, and denies the remaining allegations of plaintiff's said contention. Should the court determine that the said contract was modified, as contended, then defendant denies that it prevented plaintiff from removing the salvaged steel, and further denies that at the time plaintiff salvaged said steel, more than 18 months after he entered into the within contract, he could have sold the salvaged steel for a sum of \$14,500, and affirmatively alleges that plaintiff, because of the steady drop in the prices of steel that continued from the time of the awarding of the within contract, and because of plaintiff's procrastination and delay in entering upon and proceeding to act under the contract, plaintiff could not have sold said steel for more than \$7,238.

11. Answering Plaintiff's Contention No. 11, defendant denies that it was guilty of any wrongful conduct, denies that it refused by threat of force or otherwise to allow plaintiff to remove salvaged steel from defendant's premises, and specifically denies that plaintiff was damaged in the sum of \$14,500 or in any other amount.

12. Defendant, its agents and employees, during all times herein, exercised due care in all matters referred to in plaintiff's contentions.

13. That although the contract awarded in response to plaintiff's bid herein was accepted by defendant on March 20, 1952, and although under the contract plaintiff was to have paid for and removed all of said property on or before December 1, 1952, plaintiff made no attempt prior to December 1, 1952, to remove any of the property herein involved, and any and all damages, if any, suffered by plaintiff, were, therefore, due to his own breach of the contract.

14. That no property was salvaged by plaintiff under this contract until during the fall of 1953, at which time plaintiff removed approximately one-half of the steel covered by the aforesaid contract, and thereafter plaintiff failed and refused to proceed further under the said contract or to sell the steel thus removed, but allowed it to lie upon the banks of defendant's canal.

15. That defendant has done no act or thing between the 20th day of March, 1952, and the 4th

day of January, 1954, in preventing plaintiff from performing under the within contract, nor has the government breached any covenant or condition contained in the aforesaid contract.

16. By reason of plaintiff's default and because plaintiff failed and refused to sell the locks that he had salvaged, and since the great weight of the salvaged locks on the banks of the canal was a hazard, defendant was compelled to and did, as plaintiff's agent, sell the locks to the highest bidder for the sum of \$4,387.98, said sum being the largest amount that could be obtained for said steel at said time and place. That after crediting the said sum to the delinquent balance then owing by plaintiff, there was due and owing from plaintiff to defendant the sum of \$1,612.02.

17. That the defendant in advertising and selling the lock gates herein involved to plaintiff, did so on an "as is—where is" basis and made no representations or warranties, express or implied, or in any way misdirected or misinformed plaintiff as to the difficulties of removal of the said property, and in fact, defendant now stands ready to pass title to the remaining property to plaintiff upon plaintiff's paying the full contract price in fulfillment of the contract terms. All the terms and conditions of paragraph 2 of "the general sales terms and conditions" are incorporated herein by this reference.

18. That notwithstanding the contract provision providing that plaintiff must remove the said property on or before December 1, 1952, the defendant



nevertheless by sufferance allowed plaintiff up to January 4, 1954, to fulfill and carry out the terms agreed to by him.

19. There was no formal extension of time between the parties to this contract, and defendant did on December 15, 1953, by registered letter, return receipt requested, directed to plaintiff, advise him that the government allowed him until January 4, 1954, within which to meet the balance of his contract obligations, and that if he did not do so on or before that date, that the defendant would thereby terminate all of his rights possessed under the afore-said contract.

20. That being in default under said contract and in accordance with an option contained in said contract, defendant gave plaintiff ten days written notice that plaintiff was being given until January 4, 1954, to meet the balance of his contract obligation to defendant, and if he failed to do so that on said date defendant would terminate all further rights of plaintiff in said contract; that plaintiff did not fulfill the terms of said contract by said date of January 4, 1954, and defendant did on said date terminate the said contract, thereby cancelling all of plaintiff's rights thereunder.

21. That if plaintiff suffered any damage, loss or injury, such loss, damage or injury was due solely to plaintiff's own negligence, mistakes, and lack of good judgment in failing to inform himself of the amount, condition and location of the materials to be salvaged and the cost and extent of the



operations which he would have to undertake if he were the successful bidder; and further that any loss, damage or injury was further contributed to by plaintiff's lack of interest and procrastination in failing to diligently and promptly perform under the contract, and specifically in failing to pay for and remove the steel purchased under said contract prior to December 1, 1952, or at any other time up to January 4, 1954, although defendant did continually and at all times demand that he fulfill the terms of the contract.

22. That no act or failure to act of defendant, or any agent or employee of defendant, was the proximate cause of any damage, loss or injury sustained by plaintiff.

23. That defendant's liability, if any, is contractually limited by Paragraph 11 of the General Conditions of the plaintiff's contract, which reads as follows:

“11. Limitation on Government liability. In any case where liability of the Government to the Purchaser has been established, the extreme measure of the Government's liability shall not, in any event, exceed refund of the purchase price or such portion thereof as the Government may have received.”

24. That if plaintiff had a valid dispute under the aforesaid contract, he failed to exercise his rights to appeal by virtue of clause 15 of said contract, and the defendant therefore asserts that be-

cause of his failure to pursue his administrative remedies, the acts complained of by plaintiff are not actionable herein.

25. That plaintiff's claim should be disallowed and defendant should be given judgment against plaintiff in the sum of \$1,612.02, together with interest thereon at the rate of 6% per annum from December 1, 1952, and for its costs and disbursements herein incurred.

26. That if the court finds that the modification of October 31, 1952, was valid and binding upon the parties herein and operated to extend the time within which plaintiff was to complete performance under the contract, then defendant contends that said agreement implied that plaintiff would have a reasonable time to remove said steel and to make full and final payment of the purchase price of said steel; that the granting to plaintiff by defendant until January 4, 1954, to perform in the premises fully, was reasonable.

27. Since plaintiff's salvage operations were concluded and fully terminated prior to October 12, 1953, defendant was legally justified under the terms of said contract in terminating plaintiff's rights under said contract on January 4, 1954, and in selling the salvaged steel for the account of plaintiff.

28. The finding of December 15, 1953, by the contracting officer or those authorized to act for him, was a determination of a dispute involving a speci-

fication of the contract herein involved, and since plaintiff did not appeal therefrom within the time as set forth in the "Disputes" clause of the said contract, said findings and determination were final and conclusive upon the parties herein.

### Issues of Fact and Law

1. Whether the parties were mutually mistaken as to the amount of steel which it was possible to remove from the canal.

(Defendant contends that this is not an issue in this case.)

2. If the parties were mistaken, to what extent should the contract be reformed with respect to the amount of the purchase price?

(Defendant contends that this is not an issue in this case.)

3. Whether the contracting officer modified the contract by modification of the one dated October 31.

4. Whether the defendant breached the contract as modified.

5. Whether the defendant suffered any damages as a result of said breach, if any.

6. What amount, if any, is plaintiff entitled to recover from defendant or defendant entitled to recover from plaintiff?

### EXHIBITS

#### Plaintiff's:

1. Original of invitation bid and acceptance

signed by F. C. Hathaway and L. W. Bixby, Contracting Officer.

2. Modification No. 1 dated October 31, 1952.

3. Letter from plaintiff to Corps of Engineers, U. S. Army, dated October 12, 1953.

4. Letter dated December 15, 1953, from John A. Graf to plaintiff.

5. Letter dated January 6, 1954, to L. W. Bixby from L. C. Hathaway.

6. Letter dated March 12, 1954, to F. C. Hathaway from John A. Graf.

7. Plan and section drawing of Cascade Locks, dated February 19, 1952.

Defendant's:

8. Letter dated November 21, 1952, from F. C. Hathaway to Corps of Engineers.

9. (a) "Invitation to Bid," February 3, 1954, covering lot, scrap, iron or steel of approximately 517 tons.

(b) Office Memo, February 17, 1954, Bixby to Legal Branch.

(c) Copy "Collection Voucher," March 3, 1954, sent to plaintiff.

(d) Registered letter, March 12, 1954, Graf to Hathaway.

10. Memo, October 30, 1952, Luehring.

11. Letter, March 8, 1955, Mears to Corps of Engineers.

[The following were substituted by order 12/13/55.]

Plaintiff's:

12. Memo, October 30, 1952, Luehring.
13. Photographs a to b included.

Defendant's:

14. Photostats of Log entries "Cascade."
15. Deposition, Lewis Smith.

It Is Hereby Ordered that the foregoing is a pre-trial order in the above-entitled case, that it supercedes the pleadings, which are hereby amended to conform hereto, and that said pretrial order shall not be amended upon trial except by consent or by order of the court to prevent manifest injustice.

Dated this 18th day of April, 1955.

/s/ GUS J. SOLOMON,  
District Judge.

The Foregoing Form of Pretrial Order Is Hereby Approved:

/s/ WALTER J. COSGRAVE,  
Of Attorneys for Plaintiff.

/s/ VICTOR E. HARR,  
Assistant United States Attorney, of Attorneys for  
Defendant.

[Endorsed]: Filed April 18, 1955.



[Title of District Court and Cause.]

### MEMORANDUM

Some difficulties I see in the way of plaintiff's recovery:

1. In the fall of '52 when the diver first went down, plaintiff knew or should have known, he could only get out half the gates.

2. Knowing this, he accepted the modification of October 31, 1952, which still calls for full payment only in different manner.

3. When the contracting officer at the instance of the legal department repudiated the modification agreement, plaintiff should have stopped them to minimize his damages.

4. That he could have got the steel to Portland to avail of the \$28.00 offer is speculative; likewise, that he could have processed the 500 odd tons that were salvaged into smaller pieces.

If counsel desire to submit further memoranda I will be glad to consider them.

Dated December 30, 1955.

/s/ CLAUDE McCOLLOCH,  
Judge.

[Endorsed]: Filed December 30, 1955.

In the United States District Court  
for the District of Oregon

Civil No. 7443

F. C. HATHAWAY,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

FINDINGS OF FACT, CONCLUSIONS OF  
LAW, AND JUDGMENT

This cause having come one regularly for trial before the undersigned Judge of the above-entitled Court, plaintiff appearing in person and by Mr. Walter J. Cosgrave, his attorney, and the defendant appearing by Mr. Victor E. Harr, Assistant United States Attorney, and the Court having heard the evidence adduced by the parties and the arguments of counsel, and the Court having taken the matter under advisement and thereafter the case having been reargued by counsel and the Court being fully advised, now makes the following:

Findings of Fact

1. This suit arises out of a contract between the plaintiff and the defendant, and the amount of the claim does not exceed Ten Thousand Dollars (\$10,000.00).

2. On or about the 20th day of March, 1952, plaintiff and defendant entered into a contract

numbered DA-(S)-35-026-eng-12 for the sale of certain steel lock gates located at the old Government locks, Cascade Locks, Oregon, which locks were below the level of the waters of the lake formed by Bonneville Dam.

3. Under the contract plaintiff agreed to buy and defendant agreed to sell approximately 985.3 gross tons of steel contained in 4 sets of lock gates for a price of \$7,500, \$1,500 of which was paid as a bid deposit.

4. In the Fall of 1953, plaintiff removed from the water a part of the property to be salvaged under this contract of the approximate weight of 517 tons which was placed by plaintiff on the banks of the old lock canal at Cascade Locks, Oregon. Defendant extended invitations to bid upon the aforesaid 517 tons of steel, and thereafter sold said steel for the sum of \$4,387.98.

5. On March 12, 1954, defendant credited to plaintiff the amount received on the aforesaid bid, to wit: \$4,387.98.

6. The parties were mutually and equally mistaken as to the amount of steel which it was practicably possible to remove from the old Cascade Locks.

7. Only one-half of the amount of the steel which the parties contemplated could be removed was practicably possible of removal.

8. The parties each understood that all of such

steel could be removed, and neither intended that the contract would include steel which could not be so removed.

Based upon said Findings of Fact, the Court makes the following:

### Conclusions of Law

1. The purchase price should be reduced one-half, or \$3,750.00.
2. Plaintiff has overpaid defendant in the amount of \$2,137.98.
3. Defendant is not entitled to prevail on its counterclaim.

Now, Therefore, based upon said Findings of Fact and Conclusions of Law, it is

Ordered, that judgment be entered in favor of plaintiff and against the defendant in the sum of Two Thousand One Hundred Thirty-Seven and 98/100 Dollars (\$2,137.98) and that defendant take nothing by its counterclaim. No costs.

Dated this 19th day of April, 1956.

/s/ CLAUDE McCOLLOCH,  
Judge.

Lodged April 18, 1956.

[Endorsed]: Filed April 19, 1956.

[Title of District Court and Cause.]

### NOTICE OF APPEAL

To: F. C. Hathaway, Plaintiff, and Walter J. Cosgrave, Esquire, Maguire, Shields, Morrison & Bailey, attorneys for Plaintiff:

Notice is hereby given that United States of America, defendant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Judgment entered in this action on the 19th day of April, 1956, in favor of plaintiff and against defendant.

Dated this 14th day of June, 1956.

C. E. LUCKEY,

United States Attorney for  
the District of Oregon;

/s/ VICTOR E. HARR,

Assistant United States Attorney, of Attorneys for  
Defendant.

[Endorsed]: Filed June 14, 1956.

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[Title of District Court and Cause.]

### ORDER

This matter coming on to be heard ex parte this day upon motion of defendant-appellant, through its attorneys, C. E. Luckey, United States Attorney for the District of Oregon, and Victor E. Harr, Assistant United States Attorney, for an order ex-



tending time for the filing of the record on appeal and docketing the within action in the United States Court of Appeals for the Ninth Circuit, to enable the reporter to complete the transcript of testimony, and the Court being fully advised in the premises,

It Is Ordered that the time for filing the within appeal and docketing the action be and it is hereby extended to ninety days from June 14, 1956, the first date of filing the Notice of Appeal.

Dated this 18th day of July, 1956.

/s/ CLAUDE McCOLLOCH,  
Judge.

[Endorsed]: Filed July 18, 1956.

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In the United States District Court  
for the District of Oregon

No. Civil 7443

F. C. HATHAWAY,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

TRANSCRIPT OF PROCEEDINGS

Before: Honorable Claude McColloch, Chief Judge.

December 13, 1955.

Appearances:

WALTER J. COSGRAVE,

Of Attorneys for Plaintiff.

VICTOR E. HARR,

Assistant United States Attorney, of Attorneys for Defendant.

\* \* \*

F. C. HATHAWAY

the plaintiff herein, was produced as a witness in his own behalf and, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Cosgrave: [2\*]

\* \* \*

Q. Had you ever done any of this kind of salvage work before?

A. No, not of this particular type. A lot of other types of work, but nothing like this.

Q. You had not done any diving or removing—had you ever done any diving?

A. Well, I have myself a little bit once, a long time ago.

Q. You have never done any commercial diving?

A. No, never.

Q. You haven't had any experience with removing lock gates before?

A. No, I haven't. [3]

\* \* \*

Q. All right. After the bid was awarded to you did you move up to Cascade Locks?

A. I did, yes.

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\*Page numbering appearing at top of page of original Reporter's Transcript of Record.

(Testimony of F. C. Hathaway.)

Q. Did you move your family up there?

A. First I went up by myself. Then later I moved my family up there.

Q. Then what did you do when you first got there?

A. Well, I looked the job over, tried to figure how I could best handle it. Then I was always—I knew that I still had to—at least I figured I had to pay the Government another \$6,000. I was quite sure of my finances at first, but it didn't prove out that way. And after looking the deal over, knowing what I could do and what I couldn't do, I then went back and talked to the Corps of Engineers office. [5]

\* \* \*

#### Cross-Examination

By Mr. Harr: [25]

\* \* \*

Q. You mentioned you had done some salvaging. I was wondering to what extent you had entered into that kind of work.

A. Well, I bought from the Portland Gas & Coke Company an entire plant at Astoria. That used to be the Northwest Cities Gas. I then later went back—I sold it and went back again, did a lot of dismantling and excavating, and salvaged a lot of pipe. It was all steel pipe, or that is what most of it was. And I bought railroad—just a locomotive and railroad cars, and then I had a yard of my own, a small yard, in Seaside where I bought metal.

(Testimony of F. C. Hathaway.)

Previous to that time I think we had a big school drive, or something, to help the school out.

Q. You said then that this was the first salvage operation of this type, or this was the first time that you had tried to—— [28]

A. Underwater.

Q. Yes.

A. Well, yes, that is right. I had retrieved some winches one time underneath the water, but we didn't need the services of a diver, if that is what you are referring to.

Q. Lifting 150-ton gates, you hadn't entered into any work or operations of that magnitude up to this time, had you?

A. Well, not exactly in that amount of weight, no. But I have rigged blocks to pick up Cats in its entirety out of the water, out of a mudhole. I have always been, well, we will say mechanically inclined, and I know the power of blocks and things of that nature. My dad was a machinist all his life, I guess, and worked in that kind of material.

Q. I don't want to cut you off, Mr. Hathaway, but what I was getting at primarily was this type of operation, marine operation. Had you had any previous experience in that line of operation?

A. Well, no, not so to speak. But I didn't exactly figure it was entirely a marine operation. I was going to do it from a logger's standpoint, we will say. I did prove to myself I could do it. With a little bit more elaborate work we could have gone ahead and retrieved those gates. We would still no

(Testimony of F. C. Hathaway.)

doubt have to employ a diver to hook onto the bottom gates, but as far as lifting them was concerned, I proved to myself and my friends that we could do it by just employing the use of a block and tackle—— [29]

Q. You didn't deem it necessary to have a diver up there to examine the gates or the silting that had gone on to determine the feasibility of——

A. Well, naturally I was interested in the bid, because the brochure and this accompanying diagram of the locks, from that I got their information here, and I believed that we had studied it at the time and figured we had a general knowledge of it.

Q. When you say "we" whom do you mean?

A. Well, I use myself as we—I.

Q. You were operating under an assumed name, as I understand it?      A. That is right.

Q. When you submitted your bid and before the bid opening did you not discuss this bid with someone in the office of the United States Engineers?

A. Did I?

Q. Did you not discuss this matter before the bids were opened?

A. No. To the best of my knowledge I didn't.

Q. Isn't it a fact that you talked to a man by the name of Matson on the telephone first? You called him long distance?

A. From Seaside?

Q. The day before the bid was opened?

A. I called someone—that is right—to get—I don't remember what I asked him, but I did call.



(Testimony of F. C. Hathaway.)

I think it was relative to the payment of the first fifteen hundred dollars, I believe. I mean if I had to bring it in myself, it was [30] getting so late. And I don't remember now. It has been two years ago almost.

Q. Didn't Mr. Matson at that time on that occasion, or the man that you talked to, tell you that you should go up and inspect the premises before bidding?

A. Did he tell me that on the phone?

Q. Yes.

A. Well, the only thing I can state to that, to the best of my knowledge, no. I couldn't say he did or did not, sir. I couldn't answer that.

Q. Then following that, the day after the bids were opened and before the award was given, did you not talk to a Mr. Burbott? A. I did.

Q. And at that time you were there and you talked personally to him, did you not?

A. I was in his office at the time, yes. It was no doubt as you say.

Q. That was after the opening and you saw all of the bids, didn't you, the bids that had been made for this deal? A. I saw the bids?

Q. Yes. A. No, I don't believe so.

Q. You were aware, weren't you——

A. I wasn't present when the bids were opened.

Q. I am not saying that you were. [31]

A. Oh.

Q. But were you not aware or made aware at

(Testimony of F. C. Hathaway.)

that time of the size of the bids that had been made?

A. Was I?

Q. Yes, yours, as contrasted to the others.

A. No, I don't remember that right then. It was later, I think that—I found out one of the next highest bids was around—oh, I don't remember. Mr. Burbott told me himself personally what the other bids were. I don't believe I asked him that. I can't recall it.

Q. You would not say that you didn't know at that time the amounts of the bids, or how much higher your bid was to the next highest bid?

A. No, I can't say that I rightly do.

Q. I will ask you whether or not at that time Mr. Burbott inquired of you whether or not you were satisfied with your bid?      A. Yes.

Q. And you said yes, that you were?

A. That I was satisfied with it?

Q. Yes.

A. Well, I imagine I would have been, thinking that I intended to make some money on it, thinking I could get them out. Well, I suppose anybody would be a little bit excited if he had gotten something on a bid. I mean a chance to work, and it was something that I wanted. [32]

Q. Now, you made some comment, Mr. Hathaway, about the arrangements that you had made for financing you at first, and then you said it didn't prove out that way. I just didn't understand what you were driving at. Would you explain that a little more?

(Testimony of F. C. Hathaway.)

A. Well, yes. You mean after—I had my own \$1500, and I put that up myself. And then there was another fellow there in Seaside that was going to finance me. He was going to give me the rest of the money. And they came up and looked at the job, too, and after they come up, why, then they backed out, thinking that maybe—well, it was the time and the place made it difficult. It was a rainy, stormy, bitter day, with the east wind blowing there, and we were on top of the locks and you couldn't see anything at all except one gate on top of the wall, just one corner of the gate. There was supposedly a thousand tons of steel down there, and I had faith—I mean I knew that I could get them out, which we eventually did. But, as I say, those people were going to do the work—I mean they were going to finance me, and then they backed out.

Q. You had the \$1500. That was your own money, you said?      A. That is right.

Q. And then the additional financing was to have been done by these people, your friends, or this other firm?

A. Will you repeat the question, please?

Q. You made the bid and you paid 20 per cent down, or \$1500, out of your own money, you [33] said?      A. Yes.

Q. And then the additional financing was to have been accomplished through these people that you have talked about?

A. That is right. Well, not entirely, no. I could have gotten some money, I believe, if we had gone

(Testimony of F. C. Hathaway.)

along with the idea—if they hadn't backed out I think I would have gone to the mill, or something like that, and got another \$3,000, or something to go along with it, to pay off the thing to the Government.

Q. When was this that these people came up and looked over the operation and then backed out?

A. Well, let's see. It is hard to answer that. It might have been—it wasn't too long afterwards, I don't believe.

Q. It wasn't too long afterwards after what?

A. Well, I mean after I got the bid.

Q. Was it after you put in your deadman?

A. A week, or something like that. Not too long a time. I think there was—I think there was a ten-day time limit in the contract, or something like that, for the payment of the final money. I am not sure right now, but I think there is a clause in there. I think after the deposit the entire amount has to be paid within a certain length of time. [34]

\* \* \*

### ALVIN E. LEUHRING

was produced as a witness in behalf of the defendant and, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

By Mr. Harr:

Q. State your full name.

A. Alvin E. Leuhtring.

(Testimony of Alvin E. Leuhring.)

Q. What is your occupation?

A. I am an engineer.

Q. By whom are you employed?

A. I am employed by the Corps of Engineers, Portland District.

Q. State briefly your educational background.

A. I graduated from high school in 1941, entered Kansas State College in the fall of '41, the School of Engineering, where I interrupted my educational program, and I graduated from the Kansas State College School of Engineering in 1948, in June. I then enrolled in postgraduate work for the summer session, and I came to the Portland District in search of employment and was employed by the Corps of Engineers in August, the last of August, of 1948.

Q. You have been with the Government since then?

A. I have been with the Government since that time, sir.

Q. What are your particular duties with the Government at this time?

A. At this time I am assistant to the Superintendent of [113] Operations and Maintenance at Bonneville Dam.

Q. Were you so employed in 1952 and '53?

A. At that time I was assistant to the Project Engineer as part of the technical staff.

Q. The engineer at Bonneville?

A. At Bonneville.

Q. Are you acquainted with Mr. Hathaway?



(Testimony of Alvin E. Leuhring.)

A. I am, sir.

Q. I will ask you whether or not you in company with others made a survey and made up a hydrographic chart of the Cascade Locks canal and particularly the gates and the silting that existed.

A. I did, sir.

Q. Was that in February, 1952?                      A. '52.

Q. Do you know exactly the date that you made those soundings?

A. According to the records here, it was the 13th of February, 1952.

Q. That is the exhibit that you have seen that is in evidence in this case?                      A. Yes, sir.

Q. Explain how those soundings were made.

A. Those soundings were made employing a crew, together with a boat, a work boat, which we term as a sea mule. A boat's line was laid out on the island which is across the channel to [114] establish points of reference for the courses which were run. There were three courses run, A, B and C, and so designated on the exhibit. The courses were run in their respective order, A, B and C. We ran the courses from downstream upsteam, at which time the lead line—the lead was thrown forward and allowed to sink gradually to the bottom, and at the moment of contact, which again depends upon the leadman's scale, the reading is taken. Now that course was followed, and the readings were taken approximately every ten feet. The resultant data, then, where we had particular interest in obtaining the check readings were retaken and the control

(Testimony of Carl B. Matson.)

Q. By whom are you employed?

A. Corps of Engineers, Portland District.

Q. How long have you been with the Corps of Engineers?

A. Twenty-three years.

Q. You are an office man, I believe?

A. Yes, that is right.

Q. Did you have any conversation with Mr. Hathaway before or after the bids were opened for these lock gates that are in controversy?

A. Well, I had a conversation with him over the phone the day before the bids were opened, in which he indicated that he was going to bid, and from the conversation I gathered that he had not yet inspected the job. Our bids are all on an as is where is condition, and we prefer to have them as accurate as possible. And we also in a condition like that, where they have not inspected the property, we urge them to make an inspection, and particularly in view of this particular operation. He was urged over the phone to make an inspection prior to his submitting [164] a bid.

Q. Did you make that suggestion to him at that time yourself?

A. That is right. Following the bids I heard his conversation—at the time I was assistant to Mr. Burbott, at that particular time, and when Mr. Hathaway came in the office Mr. Burbott did call his attention to quite a difference in the high bid and the next high bid. And, as he said, Mr. Hathaway did indicate that he felt he would come out

(Testimony of Carl B. Matson.)

all right on that particular offer from his experience in logging and salvage operations. [165]

\* \* \*

LEWIS SMITH

was produced as a witness in behalf of the plaintiff and, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Cosgrave:

Q. Mr. Smith, what is your occupation?

A. Marine diver.

Q. By whom are you employed?

A. Fred Devine Diving Company.

Q. How long have you been engaged in that kind of work?

A. I have been engaged since 1936 in the employment of Mr. Devine, and I started my diving in 1942.

Q. And in diving you use deep sea diving equipment?

A. Use the regulation diving equipment. [171]

Q. Would you tell the Court what types of jobs you have done in connection with that?

A. Well, I have done underwater construction.

Q. Have you done any jobs for the Bonneville Power Administration?      A. Yes.

Q. What type of work have you done up there at the dam?

A. I do survey work, go out to survey the con-

(Testimony of Lewis Smith.)

dition of wear of the concrete, and go down on inspection work to see if there is any damage to the racks.

Q. Did you in the year 1952 do any work for Mr. Hathaway here up at Bonneville Dam?

A. Yes.

Q. Do you remember about what time of year it was that you went up there?

A. It was in the fall of the year.

Q. Of 1952? A. Yes.

Q. Did you get any of those lock gates out at that time? A. No.

Q. What did you do at that time?

A. I went down and started burning on the gates, making preparations to get the gates ready to lift.

Q. Which gates were those?

A. Those was your upper gates.

Q. All right. The ones upstream away from the dam; is that [172] right?

A. Yes, the furthest upstream. They would be your No. 1 locks upstream.

Q. How far were they under water?

A. Well, the one gate was up at the time we was up there. One gate was hanging up there against the wall, and that is the gate that we started working on and burning in two so that they could pick it up.

Q. Was there any gate on the bottom of that canal there?

(Testimony of Lewis Smith.)

A. And the other gate he thought was on the bottom, and we found it in two pieces.

Q. Now do you remember how you happened to leave there in 1952? I mean did you complete your work or did you go on to another job of some kind?

A. I went on to another job.

Q. Do you remember what that was?

A. I don't remember just what job that was, there is so many jobs going.

Q. Would that have been a shipwreck down on the Coast here some place?

A. We was on shipwrecks there.

Q. Then did you return to Bonneville to Mr. Hathaway's job later that year or early the next year?

A. If I remember correctly, the water was too high when we returned, and we had to wait until the next year to finish. [173]

Q. Then did you go back there in 1953?

A. Yes.

Q. What time of year was that, if you recall?

A. I believe that was in—we was up there in September in '53.

Q. Of '53. What work did you do then with respect to those upper gates? Were they removed at that time?

A. We went down and burned holes in those to lift them.

Q. Were they lifted out?                   A. Yes.

Q. Did you at that time make any survey of the downriver gates, the two sets?



(Testimony of Lewis Smith.)

A. After he picked the gates out, then I went down and made a survey of the lower gates.

Q. Would you tell the Court what you found with respect to those lower gates?

A. Well, I went down and found the gates in a very twisted position. At the top the gates was sprung downstream until they overlapped approximately five feet on the top.

Q. What was the effect of that overlapping as far as diving operations were concerned?

A. Well, it would be a hard situation to determine where to start working in order to free the gates, or what they would do, due to the extreme current there, what they would do when you did release them. [174]

Q. There were two lower sets of gates; is that correct? A. Yes, two lower sets of gates.

Q. You have described one as being overlapped and sprung. Was that the upper or the lower of those two sets?

A. That would be the upper set.

Q. All right. Now what was the condition of the lower set?

A. The lower set was in an open position, and, as I understand it, those was only used for dewatering the locks. They wasn't used in navigation of the locks. They was open, and, as I understood it, those gates was fastened in that open position. None of the mechanism had been taken out that holds those gates open, that operates the closing and shutting of the gates, and debris, rocks and logs and

(Testimony of Lewis Smith.)

gravel was piled up in such a condition that you wouldn't be able to—you would have to remove that before you would be able to get in there to free those gates. Then you would have to work at an angle and find what held those gates in that open position and get that loosened before you would be able to tip your gates and lay them over and burn them in two.

Q. I see. And would it or would it not have been hazardous to attempt to remove that upper set of the two from a diving point of view?

A. It would have been very hazardous, and if you had removed the gates and got them laying on the bottom I believe you would have created such a current through there you wouldn't have [175] been able to work on them after they was laying on the bottom.

Q. Would it have been possible to do it any other way?

A. The only way it would have been possible to do it any other way would be to have some equipment big enough to lift the whole gates without burning them, so they could lift the whole gate without burning it in two, and be able to work them free and pull them out of there after they were burned loose.

Q. Was there any equipment available at Bonneville that could do that?      A. No.

Q. You have mentioned debris in there on those lower gates. What was the nature of that debris? Was it fine silt or was it something else?

(Testimony of Lewis Smith.)

A. It was rocks and gravel and sticks, chunks——

Q. Any trees?           A. Trees.

Mr. Cosgrave: You may cross-examine.

### Cross-Examination

By Mr. Harr:

Q. Mr. Smith, your deposition was taken by plaintiff's counsel in my office last Tuesday or Wednesday evening?

A. Yes. That was Monday.

Q. And on that occasion you examined what purported to be a copy of the exhibit that you now have in your hands; is that [176] correct? That is Plaintiff's Exhibit 7.           A. Yes.

Q. I believe you estimated when your deposition was taken that this debris that you found upon examination of the lower open gates that existed there was approximately the same depth as is shown on this exhibit?           A. Yes.

Q. That was your testimony?           A. Yes.

Q. I believe you testified that it was approximately 15 feet, or something of that kind, approximately 15 feet of debris?

A. Yes, approximately 15 feet.

Q. And you testified also, as you have here, that there was some gravel that had filled in over the years, and that there was a current such as a whirlpool that could have brought that gravel in; is that right?           A. Yes.

(Testimony of Lewis Smith.)

Q. I believe you said also that there were some logs lying there?      A. Yes.

Q. I don't believe you mentioned trees, but there were some logs there?

A. Well, it is possible trees, chunks of trees.

Q. That was not an unusual situation, was it?

A. Not the trees drifting in there, that is not. Trees will [177] drift in in pretty near any condition.

Q. You found the same condition existing down at what I believe you call the trash racks at the dam itself?      A. Yes.

Q. The Bonneville engineers have racks down there and they attempt to catch this debris and the stuff that comes down the river so as to keep it out of the turbines, I suppose?      A. Yes.

Q. That is a part of your work that you do for the engineers, Mr. Smith?      A. Yes.

Q. You go down and examine that stuff and survey it?

A. Yes. Well, I go down—they have equipment there that they rig those racks to keep the logs and chunks and things off of the racks. But when they remove the racks so that they can remove the rocks and gravel and get it clean, I have to go down and survey it and see that their racks is completely on the bottom and that everything is clean there so that they can put their racks back in place so that nothing goes through the turbines, when they open the turbines up, so that the enclosure inside the racks is clear when they put their racks back in.

(Testimony of Lewis Smith.)

Mr. Harr: Your Honor, may we have the deposition that was handed to the clerk by the reporter? May I have the seal broken so that I may have reference to it at this time?

The Court: Yes. [178]

Mr. Harr: May the record show that I am opening the envelope containing the deposition. I have had the deposition marked as Plaintiff's Exhibit 15.

The Court: It may be marked.

(Deposition of Lewis Smith, above referred to, was marked by the clerk Plaintiff's Exhibit 15.)

Mr. Harr: Also, your Honor, there was tendered the other day at the trial of this case certain photostats representing the log entries of the derrick Cascade. They were not admitted in evidence at that time, and I should like to have those marked also, if I may, as Plaintiff's Exhibit 14.

The Court: They may be marked.

(Photostatic copies of the log entries referred to were marked by the clerk Plaintiff's Exhibit 14.)

Q. (By Mr. Harr): Now, your testimony on Tuesday and your testimony today is that when you went down to examine the upper side of the lower gates you found the condition to be that the wings of the gates as they closed, one overlapped the other? A. Yes.

Q. Is that correct? A. Yes.



(Testimony of Lewis Smith.)

Q. And by virtue of that overlapping that permitted a current of water to go through? [179]

A. Yes.

Q. I believe you said also that at least one of those wings was sprung. That is correct, isn't it?

A. Yes.

Q. That was your testimony?

A. They would have to be sprung to overlap five feet. They would have to be sprung that much, to overlap five feet.

Q. You testified that if the hinges were burned off you would have to fight your gate loose where it overlapped? A. Yes.

Q. And let them tip over on the bottom. There was about 75 feet of water at that particular point?

A. Yes.

Q. Do you know about how high the gates were themselves?

A. The gates was different lengths, I think, and I don't recall taking an exact measurement on the height of the gates.

Q. The tops of the gates were under water, however? A. Yes, the top of the gates.

Q. About how many feet, approximately?

A. I would say they was about 15 feet.

Q. Now, the current is greatest, isn't it, at the time of day when it is necessary to have a big load of electricity? That is when the current is the greatest?

A. That is when the current is the greatest, and you don't have any slack current if they have enough

(Testimony of Lewis Smith.)

water in the river [180] to run generators at full speed all the time. The only time you have any slackness in the water is at the time that the river is low enough that they don't have enough water to run the generators at full capacity, and they will build up their pond a little bit after the peak load. They will slow the generators down and let the pond raise, and then speed the turbines up with a greater flow of water at such time as the peak load is on.

Q. But there were periods of the day ordinarily where it was comparatively slack water; isn't that right?

A. Well, it wasn't what you would call slack, but it would slow down, a lot less current than at the time that they was running full loads, at full capacity of the water.

Q. Now, I believe you said that the debris that you mentioned as having accumulated in this particular area was not an unusual situation to expect?

A. No, being as the locks wasn't used, as to how it got in there or where it come from, why, that would be a question. You would have to examine it and experiment before you would find where it come in there from.

Q. Now, if you had gone up there in March of 1952, or immediately preceding that, and had you been asked by Mr. Hathaway to make a survey of the conditions then and there existing, and if you found the condition as is reflected by the exhibit

(Testimony of Lewis Smith.)

you have in your hand and as you later found on your actual survey, what [181] would have been your advice to Mr. Hathaway as to the removal of those lower gates?

A. I would have told him it would not have been practical to take them out.

Q. Why?

A. Due to the condition of the water, the current, and due to the condition of the gates being sprung and no equipment heavy enough to hold the water or the gate while you were working on them. It would take a heavier equipment to hold them due to the current in there than what it would to actually lift the gate, because you would have to have a safety factor in there when you have hold of something like that, because you get a much greater load with something like that, with your current against it, than you do just picking it in slack water. You have to have quite a percentage of safety factor on your overload to pick something like that.

Q. That canal was about 90 feet across, wasn't it?

A. Yes.

Q. So the gates themselves would be approximately 45 feet long?

A. Yes.

Q. Did Mr. Hathaway ever consult with you before March 20th, 1952, and ask you to make such a survey, or did he ask you for any advice as to the conditions then and there existing?

A. No, he never made any to me. If he made any to the company I don't know about it. But as far as to me, he never made any. [182]

(Testimony of Lewis Smith.)

Q. You state that it would have taken some very heavy equipment to have lifted those lower locks out of the water? A. Yes.

Q. They would have had to have been lifted out as one unit?

A. Due to the water conditions I would say so, they would. With my experience with underwater burning, if you would open them up and lay those on the bottom where it would be a safe condition to burn, it is my belief that the water would be so swift you wouldn't be able to work down there.

Q. Well, the upper two gates of the lower set were in a closed position and that acted as a dam in itself, didn't it? A. Yes.

Q. You have had a lot of experience in diving and watching experienced salvage operators?

A. Yes.

Q. What is your opinion as to whether or not an experienced salvage operator would have attempted to have lifted those gates out of the water with the currents then and there prevailing and the conditions that you found?

A. Well, I wouldn't say they would not have attempted to take them out.

Q. There has been testimony, Mr. Smith, that when Mr. Hathaway proceeded to work himself at the upper gates, which the Cascade eventually lifted out, he had rigged up a device where there was—I think he called it a deadman, a log laid into a [183] hole and covered up, and to that was attached a line and a block and tackle. A. Yes.

(Testimony of Lewis Smith.)

Q. And the block and tackle at the other end of the line then extended down to the top of the gate?

A. Yes.

Q. And then the block and tackle line was connected to a Cat, and they were able by the Cat pulling on this block and tackle to raise the upper gates up four or five feet, as I remember, above the surface. Now, that had been Mr. Hathaway's original plan of operation. Would that have been a practical plan to have removed these lower gates?

A. No. On that upper gate what he was lifting up—he wasn't lifting the full weight of the gate with what equipment he had there. He still wasn't lifting the full weight of the gate, because the gate was broke in two and dropped down. He was lifting it up until such time as he was lifting on the other piece.

Q. It had already been broken in two?

A. Yes.

Q. That is, the gate was lying on the bottom of the river that you speak of now?

A. That is the one that was standing up on the wall.

Q. It was broken in two?

A. It wasn't clear broke in two, but one half, one section of [184] it was lying flat on the bottom. If it had been in one piece it would have been up as high as its original position against the wall.

Q. I believe his original plan was to raise these sections above the water for a given area and then



(Testimony of Lewis Smith.)

by tying up the gate so it would stay in that position burn off a top section and take that out, and then proceed to raise it further and burn off other sections.       A. Yes.

Q. Was that a practical method, in your opinion, to have completed the undertaking, even of the upper gates?

A. Well, that all depends on somebody's view of it. From my viewpoint I wouldn't attempt to do it that way without having equipment that you could lift it. Your practical way would be to lift it with some special machinery that you could lift it, unless you burned it in small enough pieces that you can handle them with light, smaller equipment, because on your underwater work it is not very practical to burn very much under water.

Mr. Harr: Your Honor, we will offer in evidence Plaintiff's Exhibits 14 and 15.

The Court: They are admitted.

(Photostatic copy of pages from the log of the Cascade, above referred to, were received in evidence as Plaintiff's Exhibit 14; the deposition of Louis Smith, [185] above referred to, was received in evidence as Plaintiff's Exhibit 15.)

Mr. Harr: No further questions.

### Redirect Examination

By Mr. Cosgrave:

Q. Just one thing, Mr. Smith. Was there any gravel on those lower gates, in behind the gates, the

(Testimony of Lewis Smith.)

ones that were open, between the gates and the canal?      A. Yes.

Q. How high was that?

A. That was right to the top of the gate, wedged in.

Q. Was there gravel and rock in the ledges of the gates themselves, the ones that were closed?

A. Yes.

Q. How high up did that come?

A. That come up just about as high as your debris, and maybe two sections higher than what the debris was right behind the gates.

Q. Mr. Harr inquired of you as to whether Mr. Hathaway asked you in 1952 if it was impractical to get at those lower gates and get them out, and you said that you would have so advised him. Did the Army Engineers ever ask you as to whether it was practicable to take those out?

A. No. [186]

Q. If they had asked you you would have told them the same thing; is that correct?      A. Yes.

Mr. Cosgrave: No further questions, your Honor.

#### Recross-Examination

By Mr. Harr:

Q. Mr. Smith—this perhaps should have been covered on my cross—you are familiar with the way they make these hydrographic surveys?

A. Yes.

Q. They make soundings and they drop a weight,

(Testimony of Lewis Smith.)

and they measure the distance the weight goes down, and through that they make a hydrographic survey?      A. Yes.

Q. In making hydrographic surveys of that kind, and as you have examined Plaintiff's Exhibit 7, would they have had any knowledge of what type of material was at the base of the canal?

A. No, they wouldn't have knowledge only of what they touched at the top, and then it would be a question of what they was hitting. In your hydrograph you get a sounding record at your highest point.

Q. I believe your testimony was that that hydrographic survey in your opinion was substantially correct?      A. Yes. [187]

Mr. Harr: That is all.

Mr. Cosgrave: No further questions.

\* \* \*

[Endorsed]: Filed August 21, 1956. [188]

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## PLAINTIFF'S EXHIBIT No. 1

### General Sale Terms and Conditions

1. Inspection—Bidders are invited and urged to inspect the property to be sold prior to submitting bids. Property will be available for inspection at the places and times specified in the Invitation. The Government will not be obliged to furnish any labor for such purpose. In no case will failure to inspect

constitute grounds for a claim or for the withdrawal of a bid after opening.

2. Condition of Property—All property listed herein is offered for sale “as is” and “where is,” and without recourse against the Government. If it is provided herein that the Government shall load, then “where is” means f.o.b. conveyance at the point specified in the Invitation. The description is based on the best available information, but the Government makes no guaranty, warranty, or representation, expressed or implied, as to quantity, kind, character, quality, weight, size, or description of any of the property, or its fitness for any use or purpose, and no claim will be considered for allowance or adjustment or for rescission of the sale based upon failure of the property to correspond with the standard expected; this is not a sale by sample.

\* \* \*

5. Payment—Payment of the balance of the purchase price, if a deposit has been made, or otherwise of the full purchase price, shall be made by cash, or by certified check, cashier's check, bank draft, postal or express money order, payable to the Treasurer of the United States. Unless otherwise specified by the Government, payment of the full purchase price, subject to any adjustment for variation in quantity or weight pursuant to Condition No. 8, must be made prior to the date specified for removal and prior to delivery of any property. If any such adjustment is necessary, then payment must be completed, unless otherwise specified by the Government, immediately

subsequent to adjustment. If the successful bidder fails to make full and final payment as herein provided, the Government reserves the right, upon written notice to the successful bidder, to sell or otherwise dispose of any or all of such property in the Government's possession and to charge the loss, if any, to the account of the defaulting bidder. The original Purchaser will in no way be released from full compliance with the terms and conditions of the sale by his resale of the property.

6. Title—Title to the items of property sold hereunder shall vest in the Purchaser as and when full and final payment is made, unless otherwise specified by the Government, and except that if the contract provides that loading will be performed by the Government, title shall not vest until such loading and such payment are completed. On all motor vehicles and motor-propelled or motor-drawn equipment requiring licensing, a certificate of release, Standard Form 97 (or a State certificate of title, if such a certificate of title has been issued to the Government), will be furnished for each such vehicle and piece of equipment.

7. Delivery and Removal of Property—The Purchaser shall be entitled to obtain the property upon vesting of title of the property in him, unless otherwise specified in the Invitation to Bid. Delivery shall be at the designated location, and the Purchaser shall remove the property at his expense. The Purchaser shall reimburse the Government for any damage to Government property caused by the re-



moval operations of the Purchaser. If the Purchaser fails to remove the property within the specified time, the Government shall have the right to charge the Purchaser and collect upon demand a reasonable storage charge if the property is stored on premises owned or controlled by the Government, or store the property elsewhere, for the Purchaser's account, and all costs incident to such storing, including handling and moving charges, shall be borne and paid by the Purchaser; in addition to the foregoing rights, the Government may, after the expiration of thirty (30) days after the date specified for removal, and upon ten (10) days' written notice (calculated from the date of mailing) to the Purchaser (which ten (10) days' written notice, may at the option of the contracting officer, be included either partly or wholly in the thirty (30) days specified above or may be in addition thereto), resell the property, applying the proceeds therefrom against the storage and any other costs incurred for Purchaser's account. Any details regarding removal of the property as may not be provided for herein, shall be arranged with the contracting officer, which arrangement shall be reduced to writing.

\* \* \*

15. Disputes—Except as otherwise specifically provided in this contract, all questions of fact involved in disputes arising under this contract shall be decided by the contracting officer, whose decision upon said facts shall be final and conclusive upon the parties, subject to written appeal by the Pur-

chaser within thirty (30) days to the head of the department or his duly authorized representative, whose decision on said facts shall be final and conclusive upon the parties hereto. In the meantime, the Purchaser shall diligently proceed with performance.

\* \* \*

Bid Invitation No. 22C-52.

### Special Conditions

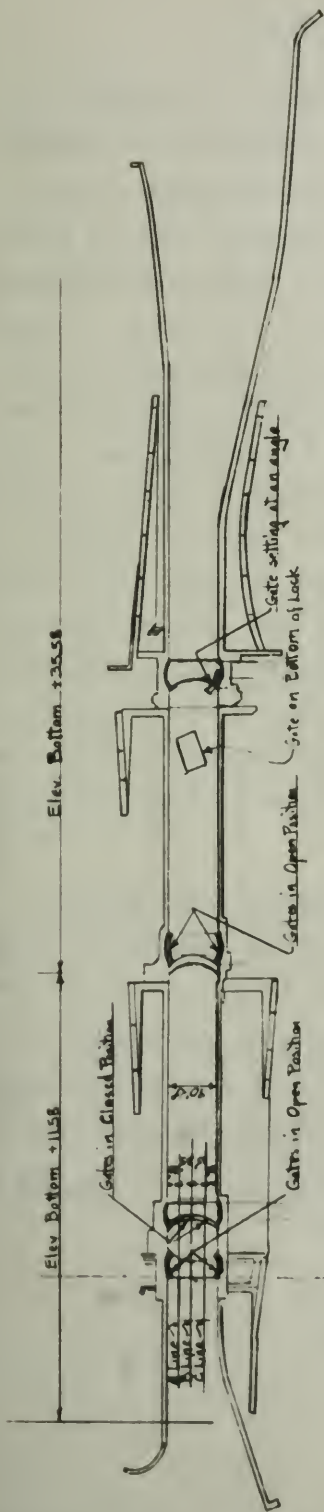
Property is sold "as is, where is." In subsequent disposal by the contractor of any scrap purchased hereunder, disposal of such scrap shall be subject to allocation by the National Production Authority, U. S. Department of Commerce, or other comparable Government Agency, in conformance with existing law.

Attached hereto is print covering recent hydrographic survey of the old locks showing approximate height of water, approximate positions of various gates and silting condition at bottom of locks.

Interested bidders may examine print showing design of gates and manner in which they are secured to lock walls by applying at 678 Pittock Block.

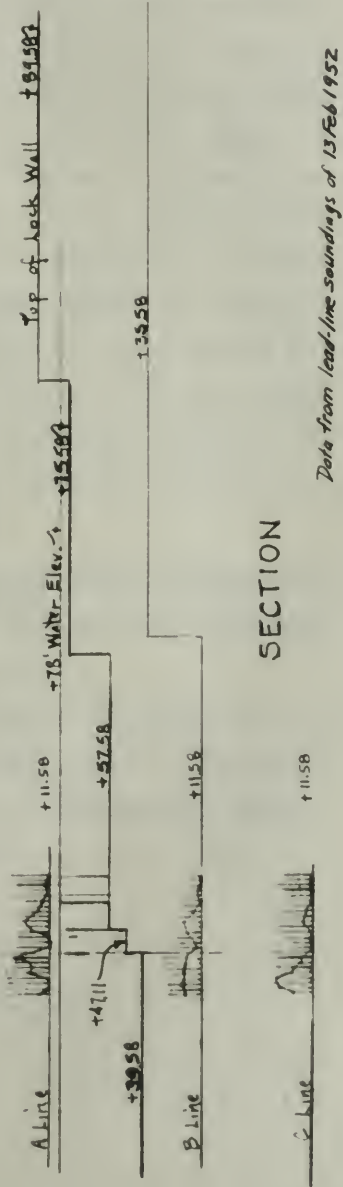
Authority: Public Law 152, 81st Congress, as amended by Public Law 754, 81st Congress.

2nd Endorsement, OCE, ENGWO, dated 5 January, 1952.



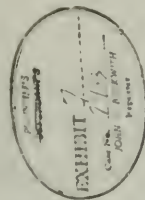
# PLAN

Scale 1" = 200'-0"



# SECTION

Data from lead-line soundings of 13 Feb 1952





United States of America,  
District of Oregon—ss.

I, R. DeMott, Clerk of the United States District Court for the District of Oregon, do hereby certify that the foregoing documents consisting of complaint, answer of United States, reply, pretrial order, memorandum, findings of fact, conclusions of law and judgment, notice of appeal, order extending time, designation of record, and transcript of docket entries, constitute the record on appeal from a judgment of said court in a cause therein numbered Civil 7443, in which F. C. Hathaway is plaintiff and appellee, and the United States of America is defendant and appellant; that the said record has been prepared by me in accordance with the designation of contents of record on appeal filed by the appellant, and in accordance with the rules of this court.

I hereby certify that the transcript of testimony dated December 13 and 23, 1955, and the exhibits, will be forwarded at a later date.

In Testimony Whereof I have hereunto set my hand and affixed the seal of said court in Portland, in said District, this 7th day of September, 1956.

[Seal]                      R. DEMOTT,  
Clerk;

By /s/ F. L. BUCK,  
Chief Deputy.



[Endorsed]: No. 15269. United States Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. F. C. Hathaway, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Oregon.

Filed September 10, 1956.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for  
the Ninth Circuit.

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United States Court of Appeals  
Ninth Circuit

No. 15269

UNITED STATES OF AMERICA,  
Appellant,  
vs.  
F. C. HATHAWAY,  
Appellee.

STATEMENT OF POINTS ON WHICH  
APPELLANT INTENDS TO RELY

The above-named Appellant, United States of America, intends to rely on the following points on its appeal to the United States Court of Appeals for the Ninth Circuit, to wit:

The District Court erred:

(1) In failing to find that plaintiff in purchasing the lock gates on an "as is—where is"

basis, bore the entire risk incident to removability of the property.

(2) In failing to find that the best information in regard to the lock gates available to the defendant was passed on to the plaintiff, that such information was substantially accurate, and that defendant made no representations or warranties, express or implied, or in any way mislead or misinformed plaintiff as to the difficulty of removal of the property.

(3) In failing to give effect to paragraph 1 of the General Conditions of the Contract which invited and urged bidders to inspect the property offered and provided that "in no case will failure to inspect constitute grounds for a claim \* \* \*."

(4) In finding that the parties were mutually and equally mistaken as to the amount of steel which it was practicably possible to remove from the old Cascade Locks.

(5) In finding that both parties understood that all of such steel could be removed and that neither intended that the contract would include steel which could not be removed.

(6) In holding that the purchase price of the contract should be reduced by one-half.

(7) In failing to hold that the complaint was subject to dismissal for failure of plaintiff to exhaust the administrative remedy available to him under the disputes clause of the contract.

(8) In granting judgment for the plaintiff.

(9) In failing to grant judgment for the defendant on its counterclaim.

Dated this 10th day of September, 1956.

C. E. LUCKEY,

United States Attorney,  
District of Oregon;

By /s/ VICTOR E. HARR,

Assistant U. S. Attorney,  
Attorneys for Appellant.

Affidavit of service by mail attached.

[Endorsed]: Filed September 11, 1956.

No. 15269

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**In the United States Court of Appeals  
for the Ninth Circuit**

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**UNITED STATES OF AMERICA, APPELLANT**

*v.*

**F. C. HATHAWAY, APPELLEE**

---

*ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR  
THE DISTRICT OF OREGON*

---

**BRIEF FOR THE UNITED STATES OF AMERICA**

---

**GEORGE COCHRAN DOUB,**

*Assistant Attorney General,*

**C. E. LUCKEY,**

*United States Attorney,*

**VICTOR E. HARR,**

*Assistant United States Attorney,*

**MELVIN RICHTER,**

**BERNARD CEDARBAUM,**

*Attorneys, Department of Justice.*

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**FILED**

**DEC - 3 1956**

**PAUL P. O'BRIEN, CLERK**





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# In the United States Court of Appeals for the Ninth Circuit

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No. 15269

UNITED STATES OF AMERICA, APPELLANT

v.

F. C. HATHAWAY, APPELLEE

---

*ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR  
THE DISTRICT OF OREGON*

---

**BRIEF FOR THE UNITED STATES OF AMERICA**

---

## **JURISDICTIONAL STATEMENT**

The United States entered into a contract with the plaintiff F. C. Hathaway for the sale to the plaintiff of certain steel lock gates located at the old Government locks, Cascade Locks, Oregon. This action was brought to recover damages in the amount of \$10,000 for the alleged breach of the contract by the Government and to have the contract reformed by reducing the purchase price of the steel locks in question (R. 3-5)<sup>1</sup>. The United States denied that it had committed a breach of contract, denied that the plaintiff was entitled to reformation of the contract price, and by way of counterclaim sought judgment against the plaintiff for the unpaid balance due on the contract (R. 5-10).

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<sup>1</sup>“(R. —)” references are to the printed transcript of record.

The district court found that while both of the parties contemplated that all of the steel which was the subject of the contract could be removed, only one-half of that amount was practicably possible of removal, and therefore the plaintiff was entitled to have the purchase price reduced by one-half and the Government was not entitled to recover on its counterclaim (R. 27-29). No specific finding was made with respect to the breach of contract issue, and since the court's judgment was entered after "being fully advised" (R. 27), presumably plaintiff's claim in this regard was rejected.<sup>2</sup> The United States filed a notice of appeal on June 14, 1956, from the judgment entered in favor of the plaintiff (R. 30), and the plaintiff has not appealed from the failure of the district court to award him damages for breach of contract.

The jurisdiction of the district court over the plaintiff's claim and the Government's counterclaim rests on 28 U. S. C. 1346 (R. 11). This court's jurisdiction is invoked under 28 U. S. C. 1291.

#### STATEMENT OF THE CASE

The contract in question was entered into on March 20, 1952. The steel lock gates which were the subject of the contract were located below the level of the waters of the lake formed by Bonneville Dam, having been largely submerged at the time of the raising of the Bonneville pool. The decision was made to place

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<sup>2</sup> In an earlier memorandum the district court had found that plaintiff's claim for damages was speculative, and it is possible that the court considered this memorandum to be dispositive of the issue (R. 26).

these gates on the scrap steel market because of the acute shortage of such steel which existed in 1952, and accordingly the U. S. Army Corps of Engineers invited bids for the purchase of the entire lot, which was stated on the bid invitation as comprising approximately 985.3 gross tons. Plaintiff's high bid of \$7500 was accepted by the Contracting Officer. In accordance with the terms of the invitation, plaintiff paid a bid deposit of \$1500, with the balance of the purchase price required to be paid prior to December 1, 1952, or prior to the removal of any property (R. 8).

The general sales terms and conditions of the contract, which all bids were made subject to, provided (R. 60-61):

1. *Inspection*.—Bidders are invited and urged to inspect the property to be sold prior to submitting bids. Property will be available for inspection at the places and times specified in the Invitation. The Government will not be obliged to furnish any labor for such purpose. In no case will failure to inspect constitute grounds for a claim or for the withdrawal of a bid after opening.

The encouragement of bidders to inspect the property was especially important because, as with the sale of much government surplus property, the lock gates were sold on an "as is, where is" basis (R. 61):

2. *Conditions of Property*.—All property listed herein is offered for sale "as is" and "where is," and without recourse against the Government. \* \* \* The description is based on the best available information, but the Government makes no guaranty, warranty, or rep-



resentation, expressed or implied, as to quantity, kind, character, quality, weight, size, or description of any of the property, or its fitness for any use or purpose, and no claim will be considered for allowance or adjustment or for rescission of the sale based upon failure of the property to correspond with the standard expected; this is not a sale by sample.

In addition, the general terms of the sale required that the full purchase price be paid "prior to the date specified for removal and prior to delivery of any property." (R. 61.) Title to the property would vest in the purchaser only upon full and final payment, and the purchaser would thereupon be entitled to remove the property, but at his own expense (R. 62). The contract made specific provision for the consequence of the purchaser's failure to meet his obligations with respect to payment and removal of the property: "If the successful bidder fails to make full and final payment as herein provided, the Government reserves the right, upon written notice to the successful bidder, to sell or otherwise dispose of any or all of such property in the Government's possession and to charge the loss, if any, to the account of the defaulting bidder." (R. 62.) And if the purchaser failed to remove the property from government premises by the specified time, the Government would be entitled to collect storage charges and had the right, after proper notice, to resell the property and apply the proceeds against those charges (R. 63).

Aside from these general terms and conditions, all bids were also made subject to certain special condi-

tions of this particular contract. It was reemphasized that the property was being sold "as is, where is" (R. 64). A chart was attached to the bid invitation prepared from a recent hydrographic survey of the old locks showing the approximate height of the water, approximate positions of various gates, and the silting condition at the bottom of the locks (R. 64-65). Bidders were also invited to examine a print showing the design of the gates and the manner in which they were secured to the lock walls (R. 64).

Despite the various provisions in the bid invitation which indicated that an inspection of the property should be made before a bid was submitted, and despite the direct urging of the plaintiff by at least one employee of the Corps of Engineers in this regard (R. 44), the plaintiff failed to make an inspection prior to submitting his bid (R. 32-33, 35, 44). This was true even though the plaintiff admittedly lacked experience in this type of a salvaging operation (R. 32-35). After the bid was made and accepted, he inspected the job site with other persons with whom he had made tentative arrangements to assist in the financing of his operation,<sup>3</sup> but these persons after examining the site and apparently concluding that the removal would be very difficult, declined to give

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<sup>3</sup> The employee of the Corps of Engineers responsible for this contract testified that when plaintiff made this inspection, his attention was called to the substantial spread between his bid and the other bids; despite this, plaintiff indicated that he felt he would come out all right on this particular offer from his experience in logging and salvage operations (R. 44-45; Tr. 162-163). Mr. Hathaway did not deny this, but claimed that he did not recall the conversation (R. 36-37).

the plaintiff the financial backing he needed and expected (R. 37-39).<sup>4</sup>

The plaintiff proceeded with the work with the equipment he had available in the fall and winter of 1952. Before the end of the year, the divers whom he had employed were called away to work on another job and plaintiff's operations came to a halt (R. 47). When the divers returned, the water was too high for the operation to continue until after the passage of the high water in September 1953 (*ibid.*). Although the contract required that the property be removed and paid for prior to December 1, 1952

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<sup>4</sup> Because of the fact that the plaintiff was underfinanced, he was able to persuade the Contracting Officer that it was impossible for him to pay the balance of the purchase price until he had received payment for the salvaged steel. Accordingly, on October 31, 1952, the Contracting Officer purported to modify the payment terms of the contract by permitting removal of the salvaged property from the government premises directly to the plaintiff's points of sale in Portland, Oregon, subject to the Government obtaining the full amount received for each load until full payment had been made. Plaintiff contended that the Government's failure to recognize the effectiveness of this modification and to allow him to remove the steel in accordance with it resulted in a loss of profits for which he sought damages (R. 13-14). The Government contended that the modification was ineffective because it was outside the scope of the Contracting Officer's authority and because it was made without consideration (R. 14-15). In addition, the Government denied that it had prevented the plaintiff from removing the salvaged steel and denied that he could have sold the steel for the prices he claimed, but alleged that plaintiff's loss, caused by a steady drop in the market price of steel, was due to his own delay in proceeding under the contract (R. 17). As stated, *supra* p. 2, the district court made no findings on this issue, and since plaintiff has not brought an appeal on this portion of the case, no further discussion of it will be made.

(R. 12), the Government acquiesced in this delay in performance. In the fall of 1953, plaintiff removed from the water a part of the property to be salvaged under the contract, of the approximate weight of 517 tons, which he placed on the banks of the old lock canal (R. 28). This consisted of the lock gates at the upper end of the canal, but when the diver examined the gates at the lower end, he found that because of the depth, the silt and other debris, and the fact that one lock was sprung, the removal of any more steel would be economically unfeasible and too hazardous for diving operations (R. 48-50). Accordingly, plaintiffs salvaging operations were discontinued.

The Corps of Engineers then extended the time for payment of the purchase price and removal of the steel from the canal banks until January 4, 1954, at which time plaintiff's rights would be terminated if he had failed to comply with his contractual obligations (R. 14, 15). No further payments having been received by that time, the Government on February 3, 1954, issued invitations to bid on the 517 tons of steel lying on the canal banks and subsequently sold the steel for the sum of \$4,387.98, which amount was credited to plaintiff's account (R. 12-13). Thereafter, this suit was instituted seeking damages for the alleged breach of the modification agreement by the Government and seeking a reduction in the purchase price of the contract by one-half (R. 3-5).

The district court found that "the parties were mutually and equally mistaken as to the amount of



steel which it was practicably possible to remove from the old Cascade Locks" and that "the parties each understood that all of such steel could be removed, and neither intended that the contract would include steel which could not be so removed" (R. 28-29). Accordingly, the court concluded that the purchase price should be reduced by one-half, or \$3,750 (R. 29). Since the plaintiff had paid \$1,500 as a bid deposit and his account had been credited with the \$4,387.98 proceeds of the government sale, judgment was entered in favor of the plaintiff for \$2,137.98 and the Government took nothing by its counterclaim (*ibid*).

#### SPECIFICATION OF ERRORS

The district court erred:

(1) In failing to find that plaintiff in purchasing the lock gates on an "as is—where is" basis, bore the entire risk incident to removability of the property.

(2) In failing to find that the best information in regard to the lock gates available to the defendant was passed on to the plaintiff, and that such information was substantially accurate, and that defendant made no representations or warranties, express or implied, or in any way mislead or misinformed plaintiff as to the difficulty of removal of the property.

(3) In failing to give effect to paragraph 1 of the General Conditions of the contract which invited and urged bidders to inspect the property offered and provided that "in no case will failure to inspect constitute grounds for a claim \* \* \*."

(4) In finding that the parties were mutually and equally mistaken as to the amount of steel which it



was practicably possible to remove from the old Cascade Locks.

(5) In finding that both parties understood that all of such steel could be removed and that neither intended that the contract would include steel which could not be removed.

(6) In holding that the purchase price of the contract should be reduced by one-half.

(7) In granting judgment for the plaintiff.

(8) In failing to grant judgment for the defendant on its counterclaim.

#### SUMMARY OF ARGUMENT

The court below, contrary to the evidence in the record, viewed this case as one of mutual mistake of the parties with respect to the amount of steel which could be removed from the old Cascade Locks, justifying a reduction by one-half of the purchase price of the contract. In so holding, the court failed to give effect to various provisions of the contract which make it clear that this was not a case of mistake since the Government intentionally, and with clear notice to the plaintiff, entertained no views with respect to the question as to which the parties were found to be mutually mistaken. The property was sold on an "as is, where is" basis and without recourse against the Government. Bidders were invited and urged to inspect the property prior to submitting bids and were advised that a failure to inspect would not constitute grounds for a claim. Furthermore, the Government expressly disclaimed warranties or guaranties of any kind in the clearest language possible. The plaintiff

knew, or should have known, of all of these terms and conditions since they were contained in the Invitation to Bid to which he responded. In these circumstances, a claim of mutual mistake could not be sustained, at least not without evidence outside of the written instrument establishing that the parties in fact contemplated a situation different from that which was subsequently found to exist. No such evidence was introduced or offered. To the contrary, the evidence shows that not only did plaintiff's potential financial backers decline to go through with the transaction when his visit to the site disclosed the difficulties of removal, but plaintiff insisted he would come out all right after the spread between his bid and the other bids was disclosed to him. At best, plaintiff has presented a case where the expectation of one party to a contract was not fulfilled and he therefore seeks relief from the other party which will compensate him for his disappointment. In granting that relief, the district court not only was at variance with usual principles of contract law, but departed from a long line of authorities interpreting the standard form contract involved in this case and holding that a purchaser can have no redress against the Government because a risk which he assumed did in fact materialize. Furthermore, we believe that the judgment of the district court is at variance with the principles of the decision of this court in *Triple "A" Machine Shop. v. United States*, 235 F. 2d 626.

In any event, the relief awarded to the plaintiff in reducing the price by one-half was speculative and not based on evidence in the record since the court

failed to take into account the fact that more than one-half of the steel was removed by the plaintiff and the cost of salvaging the remaining portion would have been considerably greater than the expense actually incurred.

## ARGUMENT

### I

Under the provisions of the contract the plaintiff bore the entire risk incident to removability of the property, and his mistaken contemplation in this regard does not constitute a ground for affording him relief

A. The terms of the written contract of sale disclaimed any view on the part of the Government with respect to removability or accessibility of the property, but placed this risk on the purchaser.

We believe that the plain meaning of the terms and conditions of this sale, which the plaintiff was aware his bid was made subject to, makes it clear that the parties intended that the purchaser was assuming the entire risk with respect to how much steel was capable of being removed. The property was sold on an "as is, where is" basis. This phrase was used both in the general terms and in the special conditions of this contract (R. 61, 64). Also, the sale was made "without recourse against the Government" (R. 61). While the description of the goods was declared to be based on the best available information, the Government made "no guaranty, warranty, or representation, express or implied, as to quantity, kind, character, quality, weight, size, or description of any of the property \* \* \*" (*ibid*). In addition, the bidders were "invited and urged to inspect the property to be sold prior to submitting bids" and all bidders were advised that "in no case will failure to

inspect constitute grounds for a claim \* \* \*'' (R. 60-61).

The only possible basis for concluding that the Government, as well as the plaintiff, intended that the contract would include only that steel which could be removed and that both understood that all of the steel was capable of removal when they agreed upon this purchase price, is that the invitation to bid contained a description of the property as comprising approximately 985.3 gross tons of steel. But we submit that it would be difficult to formulate any language which would indicate more clearly than the terms of this sale did that the Government did not intend to be bound by the description of the property given, but that the description was only intended as a general indication of the property being sold. It would be difficult to devise language which would more clearly put prospective buyers on notice that it was their duty to inspect the property, that what they were purchasing was a "cat in a bag," and that the risk that the cat would not turn out as well as they expected would have to be borne by them and therefore should be reflected in the amount of the bids which they submitted. Any reliance on the description contained in the contract was at the purchaser's own risk. And, indeed, there is no evidence to indicate that the description given, *i. e.*, that the steel lock gates contained approximately 985.3 gross tons of steel, was not entirely accurate. The Government has always stood ready to pass title to the full amount of the property described in the bid invitation upon full payment of the contract price in fulfillment of the contract terms



(R. 19). If the plaintiff is unable to effect the removal of this property, he should not be permitted now, in the light of the conditions of the sale to which he agreed, to shift the loss which he incurred as the result of his own gamble on to the Government. In reality, that is what the plaintiff seeks by this law suit.

The view of the Government in this regard is buttressed by a consideration of the special conditions of this particular bid invitation. Attached to the invitation was a print covering a hydrographic survey of the locks which showed the approximate height of the water, the approximate positions of various gates, and the silting condition at the bottom of the locks (R. 64-65). The diver employed by the plaintiff on this operation testified that this hydrographic chart was substantially accurate and that the amount of silting was not unusual (R. 50, 51, 60). He further testified that if he had been asked by the plaintiff to make a survey and if he found conditions to be as reflected in the Government's chart and as he actually did find them, he would have advised the plaintiff that it was not practical to remove the lower gates (R. 54-55). The evidence was uncontroverted that the plaintiff did not make such an investigation nor indeed did he make any inspection of the property prior to submitting his bid (R. 32-33, 44, 55). On the other hand, it was, we believe, apparent, and there is no evidence in the record to indicate the contrary, that by the hydrographic chart, by the print showing the design of the gates and the manner they were secured to the lock walls, and by the approximate description given of the amount of steel contained in the lock gates, the



Government was passing on to the plaintiff the best and most complete information which was available to it in regard to the difficulties to be expected in salvaging the property sold.

The evidence established that this information was substantially accurate, and there is no evidence to indicate that the Government made any representations or warranties or in any way misled or misinformed the plaintiff as to the difficulty of removal of the property. Indeed, the Corps of Engineers apparently was bothered by the amount plaintiff had bid; not only was a specific suggestion that plaintiff inspect the job made to him but he was shown the wide spread between his bid and the others. Plaintiff, however, declined this opportunity to withdraw and instead reaffirmed that he would come out all right on his offer from his experience in logging and salvage operations. See *supra*, p. 5, fn. 3. Thus, plaintiff was given all the help possible, but despite that, he failed to make a proper inspection and insisted that notwithstanding this critical omission, he still wished to go ahead on the job. By failing to make a proper inspection and to obtain the expert advice necessary in view of his inexperience in this type of operation (R. 32, 34)<sup>5</sup> he knowingly assumed the risk that all of the steel could be removed and that his salvaging operations would be

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<sup>5</sup> Had plaintiff not been so eager to go ahead, his optimism would have been tempered substantially by the fact that the people whom he had counted on to finance the job backed out once they visited the site and apparently became aware of the difficulties presented.

as successful as he expected. His gamble was partially lost, and now that the risk he assumed has materialized, he hardly is in a position to complain and request the Government to bail him out of his contract for he had been advised that "in no case will failure to inspect constitute grounds for a claim \* \* \* " and that the sale was made "without recourse against the Government" (R. 60, 61).

The standard provisions contained in this "as is, where is" contract have been considered many times by the courts. Such contracts are often used by the Government in disposing of its vast quantities of surplus property because, although they ordinarily bring lower prices than sales with the usual warranties and guaranties, they save the Government the time and expense of inspecting the property and provide sensible safeguards against exposure to unknown liabilities. We believe it is settled beyond dispute that the buyer in such a sale can make no claim based upon the failure of the transaction to live up to his expectations. *Maguire & Co. v. United States*, 273 U. S. 67; *Lipshitz & Cohen v. United States*, 269 U. S. 90; *Mottram v. United States*, 271 U. S. 15; *United States v. Silvertown*, 200 F. 2d 824 (C. A. 1); *American Elastics Co. v. United States*, 187 F. 2d 109 (C. A. 2), certiorari denied, 342 U. S. 829; *Samuel Furman v. United States*, 140 F. Supp. 781 (C. Cls.), certiorari denied, 352 U. S. 847; *Sachs Mercantile Co. v. United States*, 78 C. Cls. 801; *General Textile Corp. v. United States*, 76 C. Cls. 442; *Yankee Export & Trading Co. v. United States*, 72 C. Cls. 258; *Silberstein & Son v. United States*, 69 C. Cls. 412; *Snyder Corp. v. United*

*States*, 68 C. Cls. 667; *Shapiro & Co. v. United States*, 66 C. Cls. 424; *Triad Corp. v. United States*, 63 C. Cls. 151. There can be no question about the propriety of these provisions and their binding effect. While the maxim of *caveat emptor* may no longer be an implied premise of contracts of sale, here it was made one of the specific provisions of the contract. As recently stated by the Court of Appeals for the First Circuit, "under the terms of the sale, with inspection invited prior to the submission of bids, *caveat emptor* was certainly intended to be applied to the furthest limit that contract stipulations could accomplish it." *United States v. Silverton*, *supra*, at 827.

In *Lipshitz & Cohen v. United States*, *supra*, the Supreme Court had occasion to consider the rights of a buyer under an "as is, where is" sale, and especially how his rights are affected by the inclusion of a quantitative estimate in the Government's description of the property. In that case an agent of the United States listed junk for sale at several forts, setting forth that the weights shown were approximate and must be accepted as correct by the bidders. The plaintiffs, without inspection, bid a lump sum for the material "as is, where is." Although the quantities turned out to be much less than those shown on the list, it was held that the plaintiffs could not recover since the Government intended to sell the entire lot as such, and not any specific amount. "The naming of quantities cannot be regarded as in the nature of a warranty, but merely as an estimate of the probable amounts in reference to which good faith only could be required of the party making it." 269 U. S. at 92.

In the instant case, there is even less reason to hold the Government to the quantitative estimate contained in its invitation to bid, for, as we have shown, *supra*, p. 12, it is conceded that the estimate was substantially accurate as to the amount of steel contained in the lock gates, and there is nothing whatever in the bid invitation to indicate that the Government was making any representations with regard to removability. To the contrary, the terms of the sale made it clear that this was a risk assumed by the purchaser which he must evaluate for himself after making a proper inspection. In the *Lipshitz* case, the absence of a warranty was inferred from the fact that the goods were sold "as is, where is"; here, the negation of a warranty was made express (R. 61).

Similarly, in *Maguire & Co. v. United States*, *supra*, the Supreme Court again rejected the claim of a buyer who was disappointed that the property he purchased did not live up to his expectations which were based on the Government's description rather than on his own inspection. The court quoted with approval from the opinion of the Court of Claims (273 U. S. at 68-69):

Neither the plaintiff, nor its agent, inspected the material before bidding or before consummating the sale. Inspection was invited by the Government and it was expressly stated that no bids would be received subject to inspection after bidding. \* \* \* Purchasers were told, in effect, that if they bought something other than they thought they were buying they could not afterwards assert a claim upon the ground that they were mistaken in the character and quality



of the materials. \* \* \* If the plaintiff received from the Government a different material from that which it thought it had bought it is not the fault of the Government, and the plaintiff cannot recover for its own negligence.

In *American Elastics Co. v. United States*, *supra*, the plaintiff sued to rescind a contract for the sale of elastic webbing material and to recover the purchase price which he had paid, on the ground of mutual mistake since the material delivered did not correspond to the samples submitted to the buyers. The relief sought was thus substantially the same as plaintiff seeks here.<sup>6</sup> The Court of Appeals for the Second Circuit rejected the buyer's claim of breach of warranty and denied him rescission of the contract. "Nor does the soiled condition of the elastic webbing offer grounds for rescission for mutual mistake as to a material fact, for by the 'as is' terms of the contract the parties agreed that the condition of the goods was to be immaterial." 187 F. 2d 112. That was precisely

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<sup>6</sup> While in his complaint the plaintiff demanded that the contract be "reformed" by reducing the contract price one-half (R. 4-5), it is clear that this is not a proper case for reformation, but that the plaintiff is in reality seeking partial rescission of the contract. Reformation of a written instrument will be decreed only when the words it contains do not correctly express the meaning that the parties agreed upon. It is not a proper remedy for enforcement of terms to which one of the parties never assented, but is only used to make a mistaken writing conform to an antecedent expression of agreement. See 3 Corbin, *Contracts* § 614 (1951 ed.). Here, there is no claim that the written instrument did not accurately express the actual understanding of the parties; rather the contention is that a purchase price of \$7500 would not have been agreed upon had the parties not been mutually mistaken with regard to removability of the property.



the contention made by the Government in this case before the district court (R. 16-17, 23), and we respectfully submit that this unbroken line of authorities makes it clear that the district court was in error in rejecting that contention.

The Court of Claims, the court which has been called upon most frequently to deal with this problem, long ago summarized the applicable principles in the landmark case of *Triad Corp. v. United States*, 63 C. Cls. 151, 156:

Under the terms of the catalogue it is difficult to perceive how the Government could have given purchasers more specific warning than it did, that they bought at their risk what material it had and was offering for sale; that if a purchaser wished to protect himself he could do so by inspection, full opportunities for which were offered, and that if he failed to inspect and received something other than what he thought he was buying he could have no redress and could not claim allowances by reason thereof. More than that, he was distinctly told that failure to inspect would not be considered as ground for adjustment. If plaintiff neglected to embrace the opportunity offered it to inspect and purchased the property without doing so, with notice that it bought at its own risk, it created by its own negligence the situation from which it now seeks relief.

B. There is no evidence in the record to support the district court's finding that the parties were mutually mistaken as to the amount of steel which could be removed

We believe we have demonstrated that since the terms of the written contract of sale placed on the

purchaser the complete risk with respect to removability of the property, the question of whether the contract price should be reduced because of the mutual mistake of the parties was not an issue in this case. Certainly, there is nothing in the written terms to indicate that the Government had any specific understanding or contemplation with respect to removability. We have shown that no representation in this regard can be implied from the fact that the bid invitation contained an approximate estimate of the quantity of steel to be found, and that such a description was nothing more than an indication of what was being sold under the contract. And aside from the written instrument, no evidence was introduced by the plaintiff to support his contention, and the district court's finding, that this was a case of mutual mistake.<sup>7</sup> There is no evidence whatever from which the court could conclude that "the parties each understood that all of such steel could be removed, and neither intended that the contract would include steel which could not be so removed" (R. 28-29). The written contract indicates that the contrary was true, that the parties made this factor immaterial to their agreement, and there is no evidentiary basis to suppose that anything other than the clear meaning of the written agreement was intended. As Professor Corbin has stated with respect to contracts in which the buyer assumes the risk of the nonexistence of the subject matter, "In such cases, there is no mis-

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<sup>7</sup> Since no such evidence exists, it is not necessary to deal with the question of whether it would be admissible under the parol evidence rule.

take; instead, there is a conscious ignorance.” 3 Corbin, *Contracts*, § 600 (1951 ed.). That is precisely the situation here. At most, this is a case where a buyer’s expectations were not completely fulfilled, but his disappointment, or, indeed, his having made a bad bargain, does not constitute a legal basis for affording him relief. Had he inspected the property as he was urged to do, his loss might never have materialized. Instead, he plunged into the operation with only the vaguest idea of the problems which would be encountered and now seeks to have the Government bail him out when he is confronted with the realities of the situation. We know of no reason why the Government should be saddled with this burden.

C. The judgment of the district court is not in accord with the recent decision of this court in *Triple “A” Machine Shop v. United States*, 235 F. 2d 626.

While the contract involved in the decision of this Court in *Triple “A” Machine Shop v. United States*, 235 F. 2d 626, is not of the same type involved in the instant case, we believe that the principles of that decision require a result here different from that reached by the district court. In the *Triple “A”* case, the Government had solicited bids for work and services pursuant to a master contract entered into with several contractors. This master contract did not provide for the work to be performed, but did provide, upon acceptance of a bid, for the performing of work under job orders issued by the contracting officer. The plaintiff in that case successfully bid for work to be performed on certain life boats. The Invitation to Bid advised bidders of the

location of the life boats and their availability for inspection. The specification which accompanied the invitation was made a part of the job order and provided:

It is the intent of these specifications to provide for the complete repair and reconditioning both mechanically and structurally, of five (5) life boats, all as necessary to place the boats in first class operating condition and ready for use. The work shall include, but shall not be limited to, any detailed specifications which follow.

Subsequently, the Contracting Officer required Triple "A" to furnish certain materials and labor to accomplish the repair and reconditioning of the boats. This included certain items which the evidence showed beyond dispute were impossible to ascertain by inspection until after the boats had been dismantled by the contractor in the performance of the repairs. It was at this stage that the items were required for which Triple "A" sought additional compensation as extra work not included in the contract. This court held that the specification quoted above by itself justified the conclusion that the bid covered all extra material and services necessary to complete the job. 235 F. 2d at 629. This was so because the contractor had agreed by submitting a bid to perform whatever work was necessary to put the boats in proper operating condition and not to be limited by the detailed specifications. "The fact they could not see some of the work required, when they made their bid, is not a defense. They took a 'cat in a



bag.' ” 235 F. 2d at 631. Similarly, in the instant case, when the plaintiff submitted a bid subject to the condition that the property was sold “as is, where is” and without recourse against the Government, when the Government expressly disclaimed all warranties and representations, and when the bidder was advised that failure to inspect would not constitute grounds for a claim, he, too, took a “cat in a bag,” and should not be heard to complain that his expectations were not fulfilled. Indeed, in the case at bar there is even less reason to afford the plaintiff relief, for, unlike the situation in *Triple “A”*, a proper inspection would have revealed the difficulties to be encountered in an attempt to salvage the lower lock gates (R. 54-55). In both cases, the plaintiffs submitted bids subject to conditions under which they assumed the risks of unprovided-for contingencies; in both cases they should not be permitted to shift the burdens of those risks on to the Government. As stated by this court in *Triple “A”*, “Proper pleadings and proper evidence might have presented a case of mutual mistake. But we cannot remake the parties’ contract on the pleadings and record made below.” 235 F. 2d at 631. Here, too, the record does not justify the conclusion that the parties were mutually mistaken with respect to how much steel could be salvaged, although, unlike *Triple “A”*, the plaintiff did present his case on that theory. And there is nothing in the record to indicate that the contract was not intended to cover exactly what the plain meaning of its terms indicated. In *Triple “A”* the contract by its terms included all work necessary



to put the boats in operating condition; here, the contract by its terms included the sale of the complete set of lock gates without regard to removability. The contrary finding of the district court, unsupported by any evidence, should be set aside and its judgment, based on this erroneous finding, should be reversed.

## II

**The district court's modification of the contract by dividing the purchase price in half was speculative and not based on the evidence**

Having found that the parties were mutually mistaken as to the amount of steel which could be salvaged and that only one-half of the steel was practicably possible of removal (R. 28), the district court reduced the purchase price of the contract by one-half (R. 29). Even assuming that plaintiff is entitled to some relief, which we have urged is not the case, it is apparent from other findings made by the court that this figure of 50% was not arrived at by reference to the undisputed evidence as to the percentage of steel which was removed by the plaintiff and sold for his account. As agreed upon by the parties (R. 12), the court found that the contract was for the sale of approximately 985.3 tons of steel and the plaintiff removed from the water approximately 517 tons (R. 28). We can only conclude that the amount of the judgment entered in plaintiff's favor was speculative since more than 50% of the steel, based on the only estimate available, was salvaged. This is underscored by a further consideration as to which, although no findings were made,

there was evidence in the record. It is apparent from the testimony of the diver employed by the plaintiff that to remove the gates at the lower end of the canal, even if possible of removal, would have involved much greater expense than that incurred with respect to the upper gates which were known to be in shallower water and not as affected by accumulation of debris (R. 46-49, 55-58). Thus, removal of the lower gates would have involved the use of heavier equipment, would have been of greater hazard to the divers, and undoubtedly would have taken greater time. Had the district court considered these factors, as it properly should have, the amount of its award to the plaintiff would have been materially reduced. It is difficult to perceive the basis for the court arriving at the figure which it did other than the fact that such an amount was requested by the plaintiff (R. 5).

#### CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the district court should be reversed and the case remanded to that court with directions to enter judgment for the United States on both the plaintiff's claim and its counterclaim.

GEORGE COCHRAN DOUB,  
*Assistant Attorney General.*

C. E. LUCKEY,  
*United States Attorney.*

VICTOR E. HARR,  
*Assistant United States Attorney.*

MELVIN RICHTER,  
BERNARD CEDARBAUM,  
*Attorneys, Department of Justice.*



No. 15269

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United States  
Court of Appeals  
For the Ninth Circuit

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UNITED STATES OF AMERICA,  
*Appellant,*

*vs.*

F. C. HATHAWAY,  
*Appellee.*

---

Brief for Appellee

---

Appeal from the United States District Court for the  
District of Oregon

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WALTER J. COSGRAVE,  
MAGUIRE, SHIELDS, MORRISON & BAILEY,  
723 Pittock Block,  
Portland 5, Oregon,  
*Attorneys for Appellee.*

FILED

JAN - 2 1957

PAUL P. O'BRIEN, CLERK





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United States  
**Court of Appeals**  
For the Ninth Circuit

---

UNITED STATES OF AMERICA,  
*Appellant,*

*vs.*

F. C. HATHAWAY,  
*Appellee.*

---

**Brief for Appellee**

---

Appeal from the United States District Court for the  
District of Oregon

---

**INTRODUCTION**

As set forth in the agreed facts of the pre-trial order, appellee and the United States entered into a contract in March of 1952 for the sale of four sets of steel lock gates located at the old Government Locks, Cascade Locks, Oregon, which locks were below the level of the waters of the lake formed by Bonneville Dam on the Columbia River. The purchase price was \$7,500, of which the United States received \$1,500 in cash from appellee and later sold

the two gates which appellee was able to remove for \$4,387.98, or a total of \$5,887.98.

There was a controversy between the parties over removal and sale of the two sets of gates which appellee had taken from the water and appellee sued in the United States District Court, claiming breach of a modification of the contract and also asking relief as to one-half of the purchase price because of the mistake of the parties as to the amount of steel which it was possible to remove.

The Court denied the appellant's claim for damages for breach, but found that the parties were mutually mistaken as to the amount of steel which it was practicably possible to remove, that only one-half the amount of steel contemplated could be removed, that the parties understood that all of the steel could be removed, and that neither party intended that the contract would include steel which could not be so removed. Based on these findings, the Court concluded that the purchase price should be reduced by one-half, or to \$3,750.00, and since the United States had already received \$5,887.98, entered judgment for plaintiff in the sum of \$2,137.98.

By this appeal, the United States challenges the Findings of the Court in a number of respects, but confines its argument to two points and it is to those that this Brief will be directed.

## ARGUMENT

## I.

A. The cases discussed by Appellant under this heading are cases in which the contractor was claiming damages from the Government for breach of an alleged warranty of quantity or quality and in which the courts denied recovery of such damages. This argument is best answered by the case of *Triple "A" Machine Shop v. United States*, 235 F. (2d) 626, which recognizes at page 631 the distinction, which appellant fails to observe, between an action for damages and a suit for equitable relief based upon mutual mistake:

"Proper pleadings and proper evidence might have presented a case of mutual mistake. But we cannot remake the parties' contract on the pleadings and record made below."

This principle is recognized in *Howard v. Tettelbaum*, 61 Ore. 144, 120 Pac. 373, in which the parties were mutually mistaken as to the status of a particular item in the dissolution of partnership account. It was held that the contract of settlement could be reformed as to such amount.

In *Mineral Park Land Co. v. Howard*, 172 Cal. 289, 156 P. 458, the parties contemplated that certain land held gravel in quantities ready for use, but, in fact, it was removable only at prohibitive cost; in such circumstances it was held that performance should be excused.



In *Hollerbach v. United States*, 233 U.S. 165, a proposal prepared by the Government showed a filled dam as backed with broken stones, but cautioned bidders to visit the site and investigate and to ascertain the nature of the work, and the contract specifically disclaimed any warranty of the conditions as shown. The fill was not as shown. In that case, the Supreme Court held that the contractor was entitled to recover the loss which he suffered as a result of the error, notwithstanding the language of the contract.

B. There is substantial evidence to support the findings of the trial court to the effect that the parties were mutually and equally mistaken as to the amount of steel which could be removed.

The testimony of Hathaway himself was that he thought he "could get them out" (R. 37); based upon the diagram he was given (Tr. 30). The United States thought that they could be removed, since it offered the four sets of lock gates for sale. (Agreed Facts, R. 12, Bid Invitation, Ex. 1) and, according to the Government's witness Bixby, thought in 1952 that it would be economically feasible to remove the gates. (Tr. 89).

The United States understood that the upper set of the lower two sets of gates was in normal position (hydrographic survey, R. 65). The locks were under water and could not be seen (Tr. 3).

Both the United States and Hathaway were mistaken with respect to the lower two sets of locks. The testimony of the diver, Lewis Smith, whose testimony was not contradicted, was that the lower gates were sprung (R. 55), that it would have been dangerous to attempt to remove them, (R. 49, 53), that it was impossible to remove the lower gates with the equipment available, (R. 49), and that if asked, he would have informed the Army Engineers and Appellee in March of 1952 that it was impractical to remove the gates (R. 55, 59).

Since the Findings of Fact will not be set aside unless clearly erroneous, (Rule 17 F.R.C.P.), it appears that there is ample evidence from which the Court could make Findings to the effect that the parties were mistaken with respect to the steel which could be removed. Although appellant is not barred from raising the question on appeal, it is significant that the attorneys representing the United States in the trial of this case made no objection to or motion for amendment of the Findings entered.

C. The case of *Triple "A" Machine Shop v. U.S.*, 235 F. (2d) 626, contrary to appellant's interpretation, recognizes the existence of the very type of relief granted by the Court in this case. As we understand the Triple "A" case, the Court held that the District Court had properly entered a decree in favor of the United States in the plaintiff-con-

tractor's action to recover sums in addition to the contract price, but recognized that proper pleadings and proper evidence might have presented a case of mutual mistake. There is no contention in the case now before the Court that appellee was not seeking equitable relief by reason of mutual mistake.

## II.

The Court's modifying the contract by dividing the purchase price in half was not speculative, but was based on the very practical observation that two of the four sets of lock gates sold were impossible of removal. It is our understanding that two is still one-half of four and the trial court apparently reached the same conclusion.

## CONCLUSION

The United States had a very fair trial before a judge who observed the witnesses, and who carefully considered the identical arguments now repeated by the United States; his judgment should be affirmed.

Respectfully submitted,

WALTER J. COSGRAVE,  
*Attorney for Appellee.*

No. 15270

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United States  
Court of Appeals  
for the Ninth Circuit

---

ROBERT AZEVEDO, IRENE KERSHAW and  
PAUL KERSHAW, JR.,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

---

Transcript of Record

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Petition to Review Decisions of the Tax Court  
of the United States

FILED

DEC 26 1956





No. 15270

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United States  
Court of Appeals  
for the Ninth Circuit

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ROBERT AZEVEDO, IRENE KERSHAW and  
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Petition to Review Decisions of the Tax Court  
of the United States



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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## APPEARANCES

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Department of Justice,

Washington 25, D. C.

For the Respondent.





The Tax Court of the United States

Docket No. 49929

PAUL KERSHAW, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bureau Symbols—ADC: Ap: LA-SF: HTM: EMW: 90-D) Dated May 13, 1953, and as a basis of his proceedings alleges as follows:

1. The petitioner is an individual with residence at Route 2, Box 2851B, Sacramento, California. The return for the period here involved was filed with the Collector for the First California District.

2. The Notice of Deficiency, a copy of which is attached hereto and marked Exhibit "A," and made a part hereof as if set forth in full herein, was mailed to petitioner on May 13, 1953.

3. The deficiency, as determined by the Commissioner is in Income Taxes for the calendar year 1946 in the amount of Twenty-Five Thousand Nine Hundred Forty-Three and 07/100 Dollars (\$25,-943.07) of which all is in dispute.

4. The determination of tax set forth in said Notice of Deficiency is based upon the following errors:

(a) The Commissioner has erroneously found that the profits from the sale of wine from March 4th through August 6, 1946, was to be considered as those of a single proprietor of one John Azevedo with the net income allocated to Robert Azevedo and Paul Kershaw, Jr. in equal shares, since the Commissioner erred in its Findings that the corporation Mills Winery had no legal right to sell wine at wholesale without Basic Permits from the Alcoholic Tax Unit of the Bureau of Internal Revenue of the United States.

(b) The Commissioner has erred in allocating the profits from the sale of wine from March 4th, to August 6, 1946, to Robert Azevedo and Paul Kershaw, Jr., since such allocation of income to the said Robert Azevedo and Paul Kershaw, Jr., would constitute a recognition of said Robert Azevedo and Paul Kershaw, Jr., as copartners or as individuals being entitled to such profits resulting from the sale of wine without a permit being held by the said Robert Azevedo or Paul Kershaw, Jr., individually or as copartners from the Alcoholic Tax Unit of the Bureau of Internal Revenue of the United States and is thus, inconsistent with the major premises of the Commissioner in fixing and determining the deficiency herein since the major premises of the Commissioner in not recognizing such profits during the said period as corporate income, was the

fact that the corporation, Mills Winery, had not obtained a Basic Permit from the Alcoholic Tax Unit of the Bureau of Internal Revenue of the United States.

(c) The Commissioner has erred in that there was a failure to distinguish between the operation of a Winery and/or Distillery and the mere sale of wine at wholesale which was purchased by the corporation, Mills Winery, at one instance and sold at various times from March 4th to August 6, 1946.

(d) The Commissioner has erroneously disregarded the separate entity of Mills Winery, a California corporation, incorporated March 4, 1946, from the date of said incorporation to and including August 6, 1946.

(e) The Commissioner erroneously concluded that the separate entity, Mills Winery, a California corporation was dormant during the period from March 4th, to August 6, 1946.

(f) The Commissioner has erroneously interpreted the significance and meaning of certain contracts entered into between John Azevedo and Robert Azevedo and Paul Kershaw, Jr., dated December 1, 1945, and marked Exhibits "B" and "C," respectively, attached hereto and made a part hereof as if set forth in full herein in light of the conduct of said parties subsequent and prior to the execution of said agreements. Such conduct clearly evidencing ownership of wine by Robert Azevedo and

Paul Kershaw, Jr., as copartners to March 1, 1946, and thereafter, was erroneously disregarded by the Commissioner when determining the true ownership of the wine sold from March 4, 1946, to August 6, 1946.

5. The facts upon which the petitioner relies as the basis of this proceeding, are as follows:

(a) Robert Azevedo and Paul Kershaw, Jr., engaged in a copartnership business from August 1, 1945, to March 1, 1946, under the firm name and style of Mills Winery and filed with the Collector of the First California District, a partnership income tax return for said period.

(b) Mills Winery, a California corporation was organized under and by virtue of the laws of the State of California on March 4, 1946, with Robert Azevedo and Paul Kershaw, Jr., being two of the three original incorporators. The Corporation acquired at the time of its incorporation, the total bulk wine inventory of the copartnership of Robert Azevedo and Paul Kershaw, Jr., doing business under the firm name and style of Mills Winery and that said inventory at the beginning of the corporate fiscal year was the total inventory at the close of the said copartnership. This information appeared in the amended United States Corporation Income Tax Return of Mills Winery for February 28, 1946, to February 28, 1947, and the copartnership return of Income filed by Robert Azevedo and



Paul Kershaw, Jr., for the period of the existence of said copartnership terminating February 28, 1946.

(c) Mills Winery, a California corporation, filed its corporate return for the above fiscal year set forth in subdivision (b) above, with the Collector for the First California District and further filed for said period its State of California Bank and Corporation Franchise Tax Return with the Franchise Tax Commissioner of the State of California which likewise, reported the opening inventory of the corporation, Mills Winery as the inventory obtained from the partnership conducted by Robert Azevedo and Paul Kershaw, Jr.

(d) Mills Winery, a California corporation, on or about March 4, 1946, acquired from a single purchase from Robert Azevedo and Paul Kershaw, Jr., copartners, all the bulk wine premises which was the only purchase of wine made by the said corporation during the periods of March 4 to August 6, 1946.

(e) Mills Winery, a California corporation was not regularly engaged in the business of purchasing for resale at wholesale, bulk wine during the period of March 4, 1946, to August 6, 1946, but during said period Mills Winery, a California corporation made several sales of wine from the single purchase made by said corporation from Robert Azevedo and Paul Kershaw, Jr., on or about March 4, 1946.

(f) Mills Winery, a California corporation, did not have, during the period from March 4th to

August 6, 1946, a permit from the Alcoholic Tax Unit from the Bureau of Internal Revenue of the United States to act as a Winery and/or distillery. This corporation did not, during said period, engage in business as a winery and/or distillery but merely sold several parcels of wine that was purchased by the corporation in one single purchase.

(g) After March 4, 1946, namely on May 11, 1946, and on May 23, 1946, Mills Winery, a California corporation, entered into written agreements with Southern Pacific Company wherein the Mills Winery, as a California corporation, granted a license to the said Railroad "Private Road Crossing Tracks at a Grade," said agreements are attached hereto and marked Exhibits "D" and "E," respectively, and made a part hereof as if set forth in full herein.

(h) After March 4, 1946, and namely, on June 21, 1946, Mills Winery in its corporate capacity, became the owner of the real property upon which the wine premises and equipment were located, said corporate ownership was obtained by a Grant Deed by John and Frances Azevedo as Grantors and Mills Winery, a California corporation, as Grantee, said Deed was duly recorded in Volume 1294 at Page 351, of the Official Records of Sacramento County, California.

(i) From and after March 4, 1946, all wine brokers in the Oakland-San Francisco Bay Area dealt with Paul Kershaw, Jr., and Robert Azevedo

as officers of a California corporation representing said corporation that owned and held bulk wine to be sold in the open market, at wholesale.

(j) Mills Winery, a California corporation, after March 4, 1946, and namely, on April 9, 1946, entered into a written agreement with various owners of a Fruit Pulping Machine for the manufacture and sale of fruit spirits.

(k) Mills Winery, a California corporation, employed a responsible managing employee to conduct the office affairs of said corporation in April, 1946; said employee, namely, A. H. Becker, now executive director of the Federal Housing in the City of Sacramento, State of California, continuously dealt with growers, wine manufacturers and distillers, fruit processors, brokers and all persons interested in or connected with the fruit processing industries on behalf of Mills Winery, a California corporation; that all the affairs of the corporation going through the office located at the wine premises relating to the sales of wine and business dealings with those interested in the fruit processing industry, were within the knowledge of said employee from April, 1946, to January, 1950, and all such persons dealing with the office manager named herein dealt with him as an employee of Mills Winery, a California corporation.

(l) Robert Azevedo and Paul Kershaw, Jr., entered into written agreements with John Azevedo for the purchase of the winery as is more specifically

set forth in exhibits "B" and "C" to this petition hereinbefore referred to and made a part hereof but said agreements did not, in its terms prohibit the operation of Mills Winery, a California corporation in the sale of wine as distinguished from the operation of a winery which is a manufacturer of wine and distiller of spirits.

(m) Robert Azevedo and Paul Kershaw, Jr., at the time of the contracts, as set forth in exhibits "B" and "C," were executed conducted the operations at the winery premises as a copartnership. These operations did not constitute during the period of the copartnership the manufacture of wine. However, they accumulated an inventory of wine from the John Azevedo winery operation in the 1945 grape crush over which they exercised dominion and control as copartners. This wine inventory was turned over to Mills Winery, a California corporation, on or about March 4, 1946, by the copartners, Robert Azevedo and Paul Kershaw, Jr., who had at that time ceased all operations as copartners. From and after March 4, 1946, the sale of said inventory was made by the corporation to various purchasers by the corporation in its corporate capacity.

(n) The contracts entered into between Robert Azevedo, Paul Kershaw, Jr., and John Azevedo, as set forth in said exhibits "B" and "C," contemplated the copartnership operation between Robert Azevedo and Paul Kershaw, Jr., until the winery and/or distillery Basic Permits could be obtained by

Robert Azevedo and Paul Kershaw, Jr. However, the parties changed the form of their business organization on March 4, 1946, to dispose of the wine inventory and in order to operate in this regard as a corporation and not as a copartnership, the individuals did not apply for a Basic Permit but the corporation in May, 1946, did apply for such a permit and a permit was granted to the corporation.

(o) All the benefits of ownership and all the burdens of ownership of the wine inventory were transferred to the corporation. During the period of March 4th, to August 6, 1946, all moneys received from the sale of wine were deposited in a single bank account which was during said period subject to withdrawal by John Azevedo. All expenditures for the benefit of the winery during that period which were paid during that period came from this single bank account. All moneys except those sums which were spent for the actual benefit of the corporation were kept intact in this single bank account. The only difference between this bank account as it existed from March 4th, to August 6, 1946, and after August 6, 1946, was that additional signatures were filed with the bank as authorized signatures for withdrawal. Prior to August 6, 1946, and from March 4, 1946, when John Azevedo's name was the only authorized signature filed with the bank, withdrawals were made by the said John Azevedo only at the direction of the corporate officers and only for corporate purposes designated by the corporate officers. All obligations incurred during the period



of March 4, 1946, to August 6, 1946, and thereafter were paid from moneys in this single bank account. Obligations that were incurred between March 4th to August 6, 1946, for repairs, remodeling, alterations and additions to the winery premises were paid from this account before and after August 6, 1946.

(p) On or about March 4, 1946, corporate books and accounts were opened by the accountant for Mills Winery, a California corporation, that all sales of wine made during that period were picked up as corporate gross profit. All expenditures that were made after said date were picked up as corporate expenditures and said corporate books, from March 4th, to this day have been without any interruption reporting all sales, expenditures and assets of the corporation, Mills Winery, a true and correct reflection of all such matters reported to the United States Government by the Corporation Income Tax return and to the State of California by the Franchise Tax return.

Wherefore, the petitioner prays that this Court may hear the proceedings and determine that the Commissioner has erred in asserting that there is a deficiency due for the year 1946.

/s/ ROBERT C. BURNSTEIN,  
Counsel for Petitioner.

Duly verified.

**EXHIBIT "A"**

Los Angeles District-Appellate Division  
Room 710—630 Sansome Street  
San Francisco 11, California

May 13, 1953.

ADC:Ap:LA

SF:HTM:EWM:90-D

Mr. Paul Kershaw, Jr.,  
Route 2, Box 2851B,  
Sacramento, California.

Dear Mr. Kershaw:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1946, discloses a deficiency of \$25,-943.07, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days, you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise, Saturdays, Sundays and legal holi-

days are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant District Commissioner, Appellate, Room 710, 630 Sansome Street, San Francisco 11, California. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

T. COLEMAN ANDREWS,  
Commissioner;

By /s/ WM. G. WILKER,  
Assistant Head, Appellate  
Division.

Enclosures:

Statement

Form 1276

Agreement Form

ADC:Ap:LA  
SF:HTM:EWM:90-D

## Statement

Mr. Paul Kershaw, Jr.  
Route 2, Box 2851 B  
Sacramento, California

Tax liability for the taxable year ended December 31, 1946:

	Deficiency
Income Tax .....	\$25,943.07

In making this determination of your income tax liability, careful consideration has been given to your protest dated May 21, 1952, and to the statements made at the conference held on August 22, 1952.

The five-year period of limitation for assessment provided in section 275(c) of the Internal Revenue Code is held to be applicable to the taxable year ended December 31, 1946, since there was an omission from gross income of an amount which was in excess of 25% of the amount of gross income shown on the return.

A copy of this letter and statement has been mailed to your representative, Mr. Robert C. Burnstein, 414 Thirteenth Street, Oakland 12, California, in accordance with the authority contained in the power of attorney executed by you.

## Adjustment to Net Income

Year: 1946

Net income as disclosed by the original return .....	\$ 5,986.03
Unallowable deductions and additional income:	
(a) Adjustment of income from operation of Mills Winery.....	50,528.46
(b) Correction of error on page 1 of return .....	.40
(c) Adjustment of business loss....	1,720.75
Total .....	<hr/> \$ 58,235.64

## Nontaxable income and additional deductions:

(d) Adjustment of capital gain on sale of business.....	345.99	
(e) Adjustment of income from wages .....	5,000.00	5,345.99
		<hr/>
Net income as adjusted.....		\$ 52,889.65

## Explanation of Adjustments

(a) Earnings from operation of Mills Winery as shown by the return .....	None
As revised .....	\$ 50,528.46
	<hr/>
Increase in net income .....	\$ 50,528.46

It is held that the earnings from the operation of the business known as "Mills Winery" for the period from January 1, 1946, to August 6, 1946, are taxable to you as your share of community income as shown in the statement submitted herewith.

## Statement of Income

## Mills Winery

January 1, 1946, through August 6, 1946

Sales .....	\$693,114.80
Cost of sales .....	445,467.09
	<hr/>
Gross profit .....	\$247,647.71

## Expenses:

Supplies .....	\$ 2,703.98
Commissions .....	12,179.00
Freight .....	45.68
C. M. O. Tax.....	1,854.83
Labor .....	4,848.26
Utilities .....	822.47
Oil Fuel .....	236.91
Office Expense .....	428.71
Bonded Warehouse, legal.....	5,538.64
Audit expense .....	54.60
Advertising .....	180.88



Statement of Income—Mills Winery  
(Continued)

Traveling .....	308.18	
Licenses, tax .....	344.63	
S. S. Tax .....	37.87	
Unemployment .....	102.25	
Property Tax .....	520.36	
Miscellaneous Taxes .....	490.34	
Repairs .....	10,782.32	
Interest .....	469.72	
Depreciation .....	3,564.26	\$ 45,533.89
		<hr/>
Net Profit .....		\$202,113.82
		<hr/> <hr/>
Distributable		
Robert Azevedo .....		\$101,056.91
Paul Kershaw, Jr. ....		101,056.91
		<hr/>
		\$202,113.82
Distributable income of Paul Kershaw, Jr., as shown above .....		\$101,056.91
Community share taxable to wife.....		50,528.45
		<hr/>
Community share taxable to husband....		\$50,528.46

(b) Net income is increased by \$0.40, representing a correction of the amount of the loss (income from other sources), carried over to page 1 of your return from page 2.

It is held that all income received by you and your wife represents community income, one-half of which is taxable to each. In accordance therewith, the following adjustments to income have been made as explained in items (c), (d) and (e):

(c) Loss from business claimed on  
the return of

Paul Kershaw, Jr. ....	\$ 4,205.55
Loss from business claimed on the return of Irene Kershaw..	764.06
	<hr/>

Total business loss of both taxpayers .....	\$ 4,969.61
	<hr/>

Statement of Income—Mills Winery  
(Continued)

Your community one-half.....	\$ 2,484.80
Business loss claimed on your return .....	\$ 4,205.55
	<hr/>
Increase in net income.....	\$ 1,720.75
(d) Capital gain on sale of business shown by the return of	
Paul Kershaw, Jr. ....	691.98
Capital gain shown on the re- turn of Irene Kershaw.....	None
	<hr/>
Total capital gain of both taxpayers .....	\$ 691.98
Your community one-half.....	345.99
Capital gain shown on your return .....	691.98
	<hr/>
Decrease in net income.....	\$ 345.99
(e) Wages and salary income shown on the return of Paul Kershaw, Jr. ....	
	\$10,000.00
Wages and salary income shown on the return of Irene Kershaw .....	None
	<hr/>
Total wages and salary income of both taxpayers.....	\$10,000.00
	<hr/>
Your community one-half.....	\$ 5,000.00
Wages and salary income shown on your return.....	10,000.00
	<hr/>
Decrease in net income.....	\$ 5,000.00

Computation of Income Tax

Net income .....	\$52,889.65	
Less: Exemption .....	500.00	
<hr/>		
Normal tax and surtax net income.....	\$52,389.65	
Tentative tax on \$52,389.65.....		\$ 28,612.23
Less: 5% reduction .....		1,430.61
<hr/>		
Total income tax.....		\$ 27,181.62
<hr/>		
Total alternative tax .....		\$ 27,108.10
<hr/>		
Income tax liability.....		\$ 27,108.10
Income tax liability disclosed by original return Account No. 8100301, First California District .....		1,165.03
<hr/>		
Deficiency in income .....		\$ 25,943.07

Computation of Alternative Tax

Net income .....	\$52,889.65	
Less:		
Excess of net long-term capital gain over net short-gain capital loss.....	345.99	
<hr/>		
Ordinary net income.....	\$52,543.66	
Less:		
One exemption at \$500.....	500.00	
<hr/>		
Normal tax and surtax net income.....	\$52,043.66	
Tentative tax on \$52,043.66.....		\$ 28,352.74
Less: 5% Reduction.....		1,417.64
<hr/>		
Balance of tentative tax.....		\$ 26,935.10
50% of excess of net long-term capital gain over net short-term capital loss..		173.00
<hr/>		
Alternative tax .....		\$ 27,108.10
<hr/>		

## EXHIBIT "B"

## Agreement

This Agreement, made this 1st day of December, 1945, by and between John Azevedo, Party of the first part, hereinafter called "seller," and Robert Azevedo and Paul Kershaw, Jr., Parties of the second part, hereinafter called "purchasers." Witnesseth:

Whereas first party is desirous of selling to second parties that certain winery known as "Mills Winery" located at Mills Junction, California, and all the assets pertaining thereto; and,

Whereas, second parties are desirous of purchasing the same;

Now, therefore, in consideration of the mutual promises of the parties hereto, this agreement:

1. It is mutually understood and agreed by and between the parties that seller will sell to purchasers that certain winery known as Mills Winery, located at Mills Junction, California, together with all the assets pertaining thereto for the adjusted cost of said winery, plus all other of said winery, including inventory at cost price.

2. Purchasers agree to purchase said winery hereinabove mentioned under the terms and conditions stated in paragraph 1, above.

3. It is mutually understood and agreed that seller shall remain the owner of said winery until

such time as the purchasers shall be permitted to receive in their name certain basic permits which will enable them to purchase and own said winery and operate the same; provided, however, that purchasers shall, on January 1, 1946, operate and manage said winery for seller until said time as purchasers shall be able to make actual purchase of said winery, provided further that the compensation for said management, purchasers shall receive as salary the earnings of said business during said period of management.

4. It is further mutually agreed and understood by the parties hereto that unless the above-mentioned permits are issued in the names of purchasers on or before January 1, 1947, this agreement shall at the option of seller be declared null and void.

5. It is hereby understood and agreed by the parties hereto that this agreement shall apply not only to the parties hereto but to their assigns.

In Witness Whereof, the parties hereto have hereunto set their hands the day and year first above written.

/s/ JOHN AZEVEDO,

ROBERT AZEVEDO,

PAUL KERSHAW, JR.



## EXHIBIT "C"

This Agreement made and entered into this 1st day of December, 1945, by John Azevedo, doing business as the Mills Winery and, Paul Kershaw, Jr., and Robert J. Azevedo.

Whereas for a consideration, John Azevedo is selling the Mills Winery and all its assets to Paul Kershaw, Jr., and Robert J. Azevedo.

And, whereas, as owner and operator of the Mills Winery, John Azevedo has contracted obligations since August 1st, 1945. Now, as part of the consideration above referred to Paul Kershaw, Jr., and Robert J. Azevedo agree to assume and pay any judgment or judgments which may arise from Court Action or otherwise or operation of same Mills Winery between August 1, 1945, and up to and including date of actual transfer of the physical assets of the Mills Winery which will be the time that the United States Government issues to Paul Kershaw, Jr., and Robert J. Azevedo a Basic Permit to operate said Winery.

Signed: .....

Signed: .....

Received and Filed August 3, 1953, T.C.U.S.

Served August 4, 1953.

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Kenneth, W. Gemmill, Acting Chief Counsel, Internal Revenue Service, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1, 2 and 3. Admits the allegations in paragraphs 1, 2 and 3.

4(a) to (f), inclusive. Denies the allegations of error in subparagraphs (a) to (f), inclusive, of paragraph 4.

5(a). For lack of information, denies the allegations in subparagraph (a) of paragraph 5.

(b). Admits that Mills Winery, a California corporation, was organized under and by virtue of the laws of the State of California on March 4, 1946, with Robert Azevedo and Paul Kershaw, Jr., being two of the three original incorporators; for lack of information, denies the remaining allegations in subparagraph (b) of paragraph 5.

(c), (d) and (e). For lack of information, denies the allegations in subparagraphs (c), (d) and (e) of paragraph 5.

(f). Admits that Mills Winery, a California corporation, did not have, during the period from March 4th, to August 6, 1946, a permit from the

Alcoholic Tax Unit from the Bureau of Internal Revenue of the United States to act as a winery and/or distillery; admits that this corporation did not, during said period, engage in business as a winery and/or distillery; denies the remaining allegations in subparagraph (f) of paragraph 5.

(g). Admits the allegations in subparagraph (g) of paragraph 5.

(h). Admits the allegations in subparagraph (h) of paragraph 5, except denies that on June 21, 1946, Mills Winery, in its corporate capacity, became the owner of the real property.

(i) and (j). For lack of information, denies the allegations in subparagraphs (i) and (j) of paragraph 5.

(k). Admits that Mills Winery, a California corporation, employed a responsible managing employee to conduct the office affairs of said corporation April, 1946; said employee, namely A. H. Becker, now executive director of the Federal Housing in the City of Sacramento, State of California, continuously dealt with growers, wine manufacturers and distillers, fruit processors, wine brokers and all persons interested in or connected with the fruit processing industries; denies the remaining allegations in subparagraph (k) of paragraph 5.

(l). Admits that Robert Azevedo and Paul Ker-shaw, Jr., entered into written agreements with John Azevedo for the purchase of the winery as is more specifically set forth in Exhibits "B" and

“C,” to this petition; denies the remaining allegations in subparagraph (l) of paragraph 5.

(m) and (n). For lack of information, denies the allegations in subparagraphs (m) and (n) of paragraph 5.

(o). Admits that during the period of March 4th, to August 6, 1946, all moneys received from the sale of wine were deposited in a single bank account which was, during said period, subject to withdrawal by John Azevedo; admits that prior to August 6, 1946, and from March 4, 1946, when John Azevedo's name was the only authorized signature filed with the bank, withdrawals were made by the said John Azevedo; denies the remaining allegations in subparagraph (o) of paragraph 5.

(p). Admits that on or about March 4, 1946, corporate books and accounts were opened by the accountant for Mills Winery, a California corporation, that all sales of wine made during that period were picked up as corporate gross profit; admits that all expenditures that were made after said date were picked up as corporate expenditures and said corporate books, from March 4th, to this day have been without any interruption reporting all sales, expenditures and assets of the corporation, Mills Winery; for lack of information, denies the remaining allegations in subparagraph (p) of paragraph 5.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination in all respects be approved and the petitioner's appeal denied.

/s/ KENNETH W. GEMMILL,  
Acting Chief Counsel,  
Internal Revenue Service.

Filed September 9, 1953, T.C.U.S.

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[Title of Tax Court and Cause.]

### AMENDMENT TO PETITION

The court having heretofore granted to Petitioner leave to file an Amendment to his Petition heretofore filed with the above-entitled Court, the Petitioner herein does hereby amend the Petition heretofore filed by him with the above-entitled Court by adding to said Petition, Paragraphs 4-G and 5-Q, and does allege as follows:

4-G. The assessment of the deficiency as determined by the Commissioner is barred by the Statutes of Limitation, namely, Section 275, Subdivision (a) of the Internal Revenue Code as effective during the calendar year of 1947.

5-Q. That more than three years elapsed since the filing of the Income Tax Return by Petitioner for the calendar year 1946 and the determination and filing of the deficiency assessment by the Commissioner.



Wherefore, Petitioner prays that this Court may hear the proceedings and determine that the Commissioner has erred in asserting that there is a deficiency due for the year 1946.

/s/ ROBERT C. BURNSTEIN,  
Counsel for Petitioner.

Duly verified.

Received and Filed July 21, 1955, T.C.U.S.

Served July 21, 1955.

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[Title of Tax Court and Cause.]

### ANSWER TO PETITION AS AMENDED

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, pursuant to leave heretofore granted, and for answer to petition as amended and filed by the above-named petitioner, denies and alleges as follows:

4-G. Denies the allegations of error in subparagraph G of paragraph 4 of the Amendment to Petition.

5-Q. Denies the allegations in subparagraph Q of paragraph 5 of the Amendment to Petition.

7. Further answering the petition as amended, respondent alleges as follows:

(a) That petitioner omitted from gross income as reported on his income tax return for 1946 an amount properly includible therein, which is in excess of 25% of the amount of said gross income stated in said return.

(b) That if the earnings from the operation of the business known as "Mills Winery," for the period January 1, 1946, to August 6, 1946, in the amount of \$50,528.46 are held not taxable to petitioner, then, in the alternative, petitioner received a constructive dividend in the amount of \$27,500.00 by reason of the payment and satisfaction by "Mills Winery" of a debt owing by petitioner to John Azevedo.

Wherefore, it is prayed:

(1) That petitioner's appeal be denied and the Commissioner's determination in all respects be approved.

(2) That the Court determine that the assessment of deficiencies is not barred by the statute of limitations.

/s/ JOHN POTTS BARNES,  
Chief Counsel,  
Internal Revenue Service.

Filed August 23, 1955, T.C.U.S.

Served August 24, 1955.

[Title of Tax Court and Cause.]

REPLY TO RESPONDENT'S ANSWER TO  
PETITION AS AMENDED

Comes now the above-named Petitioner for reply to the allegations affirmatively set out by the Respondent in his answer, admits, denies and alleges as follows:

7(a). Denies each and every, all and singular, generally and specifically the allegations contained in Subparagraph (a) of Paragraph "7" of the Respondent's Answer to the Petition as Amended.

Further answering said Subparagraph (a) of Paragraph "7" of Commissioner of Internal Revenue's Answer to Petition as Amended, this Petitioner alleges that he did not omit from his gross income as reported on his income tax for 1946 an amount properly includible therein which is in excess of Twenty-Five Per Cent (25%) or any other sum or at all of the amount of said gross income stated in said return.

7(b). This Petitioner denies each and every, all and singular, generally and specifically the allegations contained in Subparagraph (b) of Paragraph "7" of the Commissioner's Answer to the Petition as amended.

Further answering said Subparagraph (b) of paragraph "7," this Petitioner alleges that he did not receive a constructive dividend in the amount of Fifty-Five Thousand Dollars (\$55,000.00) or any other sum at all.

Further answering said Subparagraph (b) of Paragraph "7," this Petitioner denies that the sum of Fifty-Five Thousand Dollars (\$55,000.00) or any other sum was paid by Mills Winery for the satisfaction of a debt owing by Petitioner to John Azevedo.

Wherefore, Petitioner prays that this Court determine that the Commissioner has erred in asserting that there is any deficiency due for the year 1946.

/s/ ROBERT C. BURNSTEIN,  
Counsel for Petitioner.

Duly verified.

Received and Filed September 12, 1955, T.C.U.S

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[Title of Tax Court and Cause.]

## SECOND ANSWER TO PETITION AS AMENDED

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, pursuant to leave heretofore granted, and for second answer to petition as amended and filed by the above-named petitioner, denies and alleges as follows:

4-G. Denies the allegations of error in subparagraph G of paragraph 4 of the Amendment to Petition.

5-Q. Denies the allegations in subparagraph Q of paragraph 5 of the Amendement to Petition.

7. Further answering the petition as amended, respondent alleges as follows:

(a) That petitioner omitted from gross income as reported on his income tax return for 1946 an amount properly includible therein, which is in excess of 25% of the amount of said gross income stated in said return.

(b) That on January 22, 1952, petitioner executed a Consent extending to June 30, 1953, the time within which income taxes for the year 1946 might be assessed.

(c) That if the earnings from the operation of the business known as "Mills Winery," for the period January 1, 1946, to August 6, 1946, in the amount of \$50,528.46 are held not taxable to petitioner, then, in the alternative, petitioner received a constructive dividend in the amount of \$27,500.00 by reason of the payment and satisfaction by "Mills Winery" of a debt owing by petitioner to John Azevedo.

Wherefore, it is prayed:

(1) That petitioner's appeal be denied and the Commissioner's determination in all respects be approved.

(2) That the Court determine that the assessment of deficiencies is not barred by the statute of limitations.

/s/ JOHN POTTS BARNES,

Chief Counsel,

Internal Revenue Service.

Filed September 6, 1955, T.C.U.S.

Served September 7, 1955.



The Tax Court of the United States

**Docket No. 49896**

ROBERT AZEVEDO,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

**Docket No. 49928**

IRENE KERSHAW,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

**Docket No. 49929**

PAUL KERSHAW, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

### STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto by their respective counsel, that the following facts shall be taken as true without prejudice to the right of either party to introduce

other and further evidence not inconsistent therewith.

1. Mills Winery, a California corporation, duly organized and existing under and by virtue of the laws of the State of California, incorporated March 4, 1946, located at Mills Station near the City of Sacramento, California, is engaged in the manufacturing and selling of wine and distilled fruit spirits.

2. Mr. John Azevedo, prior to 1945, was the owner of the real property and the improvements located thereon which were designed for the manufacturing of wine and spirits which was leased by the said John Azevedo to others in order to operate and maintain said winery.

On or about July, 1945, John Azevedo discontinued his lease arrangement with others and commenced operations as a sole proprietor doing business under the firm name and style of "Mills Winery." John Azevedo had issued to him in July, 1945, the necessary basic permits and licenses by the Federal Alcohol Tax Unit and the California State Board of Equalization. In July, 1945, John Azevedo negotiated for the purchase of grapes, for loans with the Capital National Bank of Sacramento for funds necessary for the purchase of grapes and crushing thereof. The preparations for the 1945 grape crush and the purchase of grapes thereof was the only activity of said John Azevedo.

At or about this time in July, 1945, the said John Azevedo employed Paul Kershaw, Jr., as a salesman

to sell wine after the same would have been manufactured and finished and employed Robert John Azevedo, his son, as the wine maker.

3. On or about August 1, 1945, John Azevedo agreed orally to sell the Winery to Robert J. Azevedo and Paul Kershaw, Jr., at "adjusted cost." The oral agreement was later reduced to written agreements dated December 1, 1945, which agreements are attached hereto and marked "Exhibit 1-A" and "2-B" respectively and incorporated herein by reference as if set forth in full herein.

4. Immediately thereafter and commencing August 1, 1945, the said Paul Kershaw, Jr., and Robert J. Azevedo, conducted the operations in connection with the crushing of grapes for the manufacturing of wine and carried out said operations to and including March 1, 1946, as copartners, at which time the said Robert J. Azevedo and Paul Kershaw, Jr., had prepared for filing with the Internal Revenue Department of the United States, a partnership Income Tax Return. That attached hereto and marked "Exhibit 3-C" is a photostatic copy of the United States Partnership Return of Income prepared for filing by Paul Kershaw, Jr., and Robert J. Azevedo with the United States Treasury Department for the period beginning August 1, 1945, and ending March 1, 1946.

5. That attached hereto and marked "Exhibit 4-D" and made a part hereof as if set forth in full herein is a photostatic copy of the Amended Cor-

poration Income Tax Return for the fiscal year beginning March 4, 1946, and ending March 3, 1947; that said Exhibit 4-D reflects that the inventory at the beginning of the corporate fiscal year, namely, March 4, 1946, amounted to \$445,467.09 which was the same amount that was reflected in the partnership return of income as the closing inventory of said copartnership on March 1, 1946, as is more specifically set forth in "Exhibit 3-C" hereinbefore referred to.

6. A financial statement prepared for the partnership on March 3, 1946, and prior to the date of the incorporation of Mills Winery, a California corporation, shows the following:

Paul Kershaw, Jr., and Robert Azevedo, DBA  
Mills Winery  
Route 2, Box 2851-B  
Sacramento, California

Financial Statement

March 3, 1946,

Assets

Inventory .....	\$445,467.09
Plant and Equipment .....	108,225.19
Land .....	5,000.00
Deferred Charges (Insurance).....	1,542.82
	<hr/>
	\$559,235.10

## Liabilities

Capital National Bank (OD.) .....	\$ 2,246.01
Accounts Payable .....	310,734.01
Accrued Taxes .....	55.08
Notes Payable .....	136,200.00
Reserve for Depreciation .....	None
Investment .....	110,000.00
	<hr/>
	\$559,235.10

Prepared without audit

Prepared by—National Accounting Service—  
Los Gatos

7. The adjusted cost of the Winery as of December, 1945, was approximately \$100,000.00 and the value of the inventory consisting of wine which was manufactured and came into being about March 1, 1946, was approximately equal to an indebtedness in the amount of \$440,000.00 representing money borrowed from the Capital National Bank, Sacramento, California, for the purpose of financing the 1945 crush.

No wine was sold and no amounts were paid on the indebtedness in 1945. John Azevedo was ultimately paid an extra \$10,000.00 over the agreed price of \$100,000.00, and the payments were made as follows:

March 22, 1946.....	\$ 5,000.00
April 17, 1946.....	10,000.00
June 24, 1946.....	45,000.00
July 4, 1946.....	50,000.00
	<hr/>
	\$110,000.00



The source of the payments to John Azevedo were from proceeds realized from the sale of wine after March 4, 1946, which was manufactured from the 1945 crush.

8. On May 1, 1946, Treasury Form 698 was executed on behalf of John Azevedo, doing business as "Mills Winery" and filed with the Federal Alcohol Tax Unit. In said Form 698 John Azevedo advised the Alcohol Tax Unit that he intended his basic permits to conduct a winery for the manufacture of wine and the distilling of fruit spirits to be discontinued as of the date similar basic permits and licenses were issued by Mills Winery, a California corporation.

On May 3, 1946, the corporation, Mills Winery, made application to the Federal authorities on Treasury Form 1634 to produce and blend wine and on Treasury Form 1639 to distill and sell distilled spirits. Attached to the application is a supplemental sworn statement as follows:

"Applicant's place of business will be purchased from John Azevedo, an individual and the present owner, when proper permits are received by applicant to engage in the operations of a Fruit Distillery. A Wine Producer's and Blender's Basic Permit, Form 1635, and a Distiller's Basic Permit, Form 1640, were issued by the Alcohol Tax Unit under date of August 13, 1946, effective 12:01 a.m. August 7, 1946."

9. The first meeting of the Board of Directors of the corporation was held on March 20, 1946, with all the directors being present. That attached hereto and marked "Exhibit E" is a photostatic copy of the Minutes of the First Meeting of the Board of Directors.

10. That on the 9th day of April, 1946, Paul Kershaw, Jr., on behalf of Mills Winery, a California corporation, executed a written agreement with certain other persons in connection with distilling Fruit Spirits; said spirits from fruits of all types to be distilled during the Fruit season of 1946, being the early Summer and late Summer of 1946. That attached hereto and marked "Exhibit 6-F" is a photostatic copy of that certain agreement entered into on the 9th day of April, 1946, by and between Mills Winery, a California corporation, and other persons, and the same is incorporated herein by reference as if set forth in full herein.

That after March 4, 1946, namely, on May 11, 1946, and on May 23, 1946, Mills Winery, a California corporation, entered into written agreements with the Southern Pacific Company wherein the Southern Pacific Company, as Licensor, and Mills Winery as Licensee, was granted by the said Southern Pacific Company to establish a private road crossing tracks at a grade and that the said agreements of May 11, 1946, and May 23, 1946, were attached to the Petitions heretofore filed by Robert J. Azevedo, Paul Kershaw, Jr., and Irene Kershaw before the Tax Court of the United States which

were described in said Petitions as "Exhibit D" and "Exhibit E," respectively; that reference is hereby made to said Exhibits D and E attached to said Petitions as if the same were set forth in full herein and made a part hereof.

11. By a Grant Deed dated June 21, 1946, John Azevedo and Frances Azevedo as Grantors granted to Mills Winery, a California corporation, all that certain real property upon which the wine premises and equipment are located. The deed was delivered by the Grantors to a Title Company in the County of Sacramento, State of California, for the benefit of the Grantee, namely, the California corporation, Mills Winery, but the escrow instructions filed by the Grantor with said Title Company contained no information regarding the delivery of the deed nor the length of time the deed was in escrow. The deed was recorded with the County Recorder of Sacramento County on November 23, 1946, in Volume 1294 at Page 351, of the official records of the County of Sacramento.

12. That from June, 1946, to and including the month of August, 1946, certain improvements, additions and alterations were being made by various General Contractors, Iron Workers, Designing Engineers and Plant Engineers relating to the Winery premises and the equipment located thereon which were all paid for by the corporation after the date of its incorporation; such payment being made from corporate funds arising out of proceeds resulting from the sale of wine from the 1945 crush.

13. At all times material herein there was a single bank account in the Capital National Bank of Sacramento, California, for the business operations of Mills Winery. During the period of August 1, 1945, to August 1, 1946, John Azevedo had the sole authority to sign checks and withdraw funds from the account.

On and after August 1, 1946, Robert J. Azevedo and Paul Kershaw, Jr., were granted permission to withdraw funds from said bank account on behalf of the corporation. All moneys withdrawn by John Azevedo from said bank account prior to March 4, 1946, were used to pay the obligations of Paul Kershaw, Jr., and Robert J. Azevedo as co-partners and all moneys withdrawn by John Azevedo after March 4, 1946, from said bank account and all expenditures that were made thereafter were made for the benefit of the corporation which came from the single bank account except the payments made to John Azevedo as described in Paragraph "7" of this Stipulation set forth above; that all bank loans, warehouse obligations and expenditures for improvements, alterations and additions made on the Winery premises and the equipment therein that were paid prior to August 1, 1946, were paid by checks drawn by John Azevedo from this single bank account and that all payments that were made after August 1, 1946, were paid by Paul Kershaw, Jr., from the same bank account.

14. On August 8, 1946, the corporation filed with the Collector of Internal Revenue, Form SS-4,

Application for Employer's Identification Number. The preceding identification number had been issued to John Azevedo, doing business under the name "Mills Winery."

15. Notifications of change in ownership of insurance policies and motor vehicles were made by the corporation during or, subsequent to August, 1946.

16. The third meeting of the Board of Directors of the corporation was held on August 12, 1946. A photostatic copy of the Minutes of this meeting marked "Exhibit G" is attached hereto and incorporated by reference herein.

17. In April, 1946, Mills Winery, a California corporation, employed A. H. Becker as the Managing Employee conducting the office affairs of said corporation. That as said employee the said A. H. Becker continuously, from April, 1946, to January, 1950, dealt with growers, wine manufacturers, distillers, fruit processors, wine brokers, and all persons interested in or connected with the fruit processing industry.

18. The corporation applied to the Corporation Commissioner of the State of California, on September 18, 1946, for permission to issue capital stock. The Corporation Commissioner granted permission on October 2, 1946, subject to the restriction that the stock be placed in escrow.

Thereafter, the corporation issued 10,000 shares of capital stock to Robert Azevedo and 10,000



shares to Paul Kershaw, Jr.; the stock, carrying a par value of \$100.00 per share was immediately placed in escrow with Robert C. Burnstein. The stock of the corporation is still in escrow.

19. On October 17, 1946, Robert J. Azevedo sold all of his stock to Paul Kershaw, Jr., for \$50,000.00.

20. During the period involved herein, 1945 and 1946, the only Basic Permits and Licenses from the Federal Alcohol Tax Unit and the California State Board of Equalization was issued to John Azevedo prior to August 7, 1946, and to the corporation thereafter.

21. The only wine sold was the wine inventory representing the 1945 crush and it was all sold during the period of March 4 to June 30, 1946. The sales were bulk sales in comparatively large quantity to consumers such as Italian Swiss Colony Wine Company, Petri Wine Company and Christian Brothers Wine Company. The invoices relating to the sales carried the name "Mills Winery."

22. The figures representing the selling price of the 1945 crush, and the expenses applicable thereto, were reported in the initial income tax return and the amended return Form 1120 filed by the corporation for the fiscal year beginning March 4, 1946, and ending March 3, 1947, as is set forth in "Exhibit 4-D" heretofore referred to.

23. That all sales of wine made during the period of March 4, 1946, to August 6, 1946, were picked up as corporate gross profit. All expenditures made

from and as of March 4, 1946, were paid as corporate expenditures and that the books from March 4, 1946, the date of incorporation of Mills Winery, a California corporation, to this date have been without interruption reporting all sales, expenditures and assets of the corporation, Mills Winery, a California corporation.

24. The Income Tax liability of Irene Kershaw, for the year 1946, is involved because of her community interest in the earnings of Paul Kershaw, Jr.

25. Photostatic copies of the 1946 Federal Income Tax Returns of Robert J. Azevedo, Paul Kershaw, Jr., and Irene Kershaw are attached hereto and incorporated by reference, being marked by "Exhibits H, I and 10-J," respectively.

/s/ JOHN POTTS BARNES,  
Attorney for Commissioner of  
Internal Revenue.

/s/ ROBERT C. BURNSTEIN,  
Counsel for Petitioners.

Dated: June 29, 1955.

Filed at hearing June 29, 1955.

## The Tax Court of the United States

**ROBERT AZEVEDO, et al.,<sup>1</sup>****Petitioners,****vs.****COMMISSIONER OF INTERNAL REVENUE,****Respondent.****Docket Nos. 49896, 49928, 49929****Filed May 7, 1956.**

**Income—Taxable to Individuals or to a Corporation:**

Petitioners, Robert Azevedo and Paul Kershaw, Jr., entered into an executory contract of sale with Robert's father, John, on December 1, 1945, under which John agreed to sell winery premises and inventory to them at such time as the petitioners should receive basic permits to make and sell wine and spirits, and further agreed that pending the receipt of the permits, the petitioners would be paid as salary in compensation for their services in operating and managing the winery, the earnings of the winery business. Petitioners managed and operated the winery, and the inventory of wine produced under their operations was sold before July 1, 1946, from which earnings were derived. Peitioners organ-

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<sup>1</sup>Docket No. 49928, Irene Kershaw, and Docket No. 49929, Paul Kershaw, Jr., have been consolidated with Docket No. 49896.

ized a corporation in March, 1946, having the same name as the business which they managed. They contend that earnings from sales of wine are taxable to the corporation. Held, that the corporation did not own an inventory of wine prior to the sale thereof; that the proceeds from sales of the wine was not the corporation's income; and that the net earnings of the winery were compensation to petitioners under the agreement. Respondent's determinations sustained.

ROBERT C. BURNSTEIN, ESQ.,

For the Petitioners.

EDWARD H. BOYLE, JR., ESQ.,

For the Respondent.

## MEMORANDUM FINDINGS OF FACT AND OPINION

Harron, Judge:

The Commissioner determined deficiencies in income tax for the year 1946 as follows:

Docket No.	Taxpayer	Deficiency
49896	R. Azevedo	\$65,020.05
49928	I. Kershaw	27,108.10
49929	P. Kershaw	25,943.07

The chief question is whether net profit of \$202,-113.82 from sales of wine during the months March through June, 1946, is taxable in equal amounts to Robert Azevedo and Paul Kershaw, Jr., as the Commissioner has determined, or is taxable to a corporation.

### Findings of Fact

In 1946 Robert Azevedo resided in Santa Cruz, California, and he was unmarried. He filed an individual income tax return with the collector for the first district of California. In 1946 Paul and Irene Kershaw were husband and wife and they resided in Sacramento, California. They filed individual returns with the collector for the first district of California. Irene is involved in these proceedings only because she and her husband reported income for 1946 on a community property basis. Since the issues to be decided relate to Robert Azevedo and Paul Kershaw, they are referred to hereinafter as the petitioners.

John Azevedo is Robert's father. John is a construction contractor and he was engaged in the construction contracting business in 1945. John Azevedo, in 1945 and before, owned realty and 5 buildings thereon at Mills Station near Sacramento. This property is a winery known as Mills Winery. Before July, 1945, John leased the winery to Christian Brothers Winery, and John did not have the permits required to make wine. The adjusted basis of the property to John was \$100,000 in 1945. At about the end of June, 1945, the lease of the winery was terminated and in July, 1945, the necessary basic permits to make wine and distilled spirits were issued to John by the Federal Alcohol Tax Unit of the Bureau of Internal Revenue and the California State Board of Equalization. John then commenced operations as a sole proprietor doing business under the name of



Mills Winery. In July, John intended to operate the winery and he called in Paul Kershaw, a salesman, to take care of sales. Kershaw had been working in Oakland, California.

In the fall of 1945, John borrowed \$440,000 from the Capital National Bank of Sacramento for the purpose of buying grapes for the making of wine and he gave his note to the bank for the loan. Also, a checking account was established in Capital National Bank for the operation of Mills Winery. John Azevedo was the only person authorized to sign checks on and withdraw funds from this account during 1945 and until about August 1, 1946.

John's son, Robert, is a winemaker. Prior to the transactions involved here he graduated from the University of California, College of Agriculture.

In about August, 1945, John made an oral arrangement with Robert and Kershaw under which they were to engage in activities at the winery during the crush in the fall of 1945. Kershaw bought grapes for the fall 1945 crush. Robert performed the services of winemaker. John, although engaged in the contracting business, was present at the winery to supervise some construction work at the winery, and, also, he attended to financial transactions with Capital National Bank. The cost of the construction work at the winery was \$10,000.

By December 1, 1945, the fall crush was completed and an inventory of wine was in process of manufacture. There remained to be done the finishing

proceses of making the wine and the sale thereof. No wine was sold during 1945. All of the wine produced from the crush in the fall of 1945 was sold during four months in 1946, namely, during March, April, May, and June.

On or about December 1, 1945, after the fall crush but before the sale of any of the wine, the agreement set forth below was made by John Azevedo, the seller, with Robert and Kershaw, the purchasers, and was executed by each party. At the same time, Robert and Kershaw executed an agreement to protect John if there should be any judgments against him on account of any obligations he incurred from August 1, 1945, until the date of the actual transfer of the physical assets of Mills Winery to Robert and Kershaw, which date was stated to be the time that the latter received the Federal basic permits under which they could operate the winery. The agreements dated December 1, 1945, are as follows:

#### Agreement

This agreement, made this 1st day of December, 1945, by and between John Azevedo, Party of the first part, hereinafter called "Seller" and Robert Azevedo and Paul Kershaw, Jr., Parties of the Second Part, hereinafter called "Purchasers." Witnesseth:

Whereas, first party is desirous of selling to second parties that certain winery known as "Mills Winery" located at Mills Junction, California, and all the assets pertaining thereto; and,

Whereas, second parties are desirous of purchasing the same;

Now, therefore, in consideration of the mutual promises of the parties hereto, this agreement;

1. It is mutually understood and agreed by and between the parties that seller will sell to purchasers that certain winery known as Mills Winery, located at Mills Junction, California, together with all the assets pertaining thereto for the adjusted cost of said winery, plus all other of said winery, including inventory at cost price.

2. Purchasers agree to purchase said winery hereinbefore mentioned under the terms and conditions stated in paragraph 1, above.

3. It is mutually understood and agreed that seller shall remain the owner of said winery until such time as the purchasers shall be permitted to receive in their name certain basic permits which will enable them to purchase and own said winery and operate the same; provided, however, that purchasers shall, on January 1, 1946, operate and manage said winery for seller until said time as purchasers shall be able to make actual purchase of said winery, provided further that the compensation for said management, purchasers shall receive as salary the earnings of said business during said period of management.

4. It is further mutually agreed and understood by the parties hereto that unless the above-mentioned permits are issued in the names of purchasers

on or before January 1, 1947, this agreement shall at the option of seller be declared null and void.

5. It is hereby understood and agreed by the parties hereto that this agreement shall apply not only to the parties hereto but to their assigns.

In Witness Whereof, the parties hereto have hereunto set their hands the day and year first above written.

Signed—JOHN AZEVEDO,  
ROBERT AZEVEDO,  
PAUL KERSHAW, JR.

This agreement made and entered into this 1st day of December, 1945, by John Azevedo doing business as the Mills Winery and, Paul Kershaw, Jr., and Robert J. Azevedo.

Whereas for a consideration John Azevedo is selling the Mills Winery and all its assets to Paul Kershaw, Jr., and Robert J. Azevedo.

And, whereas as owner and operator of the Mills Winery, John Azevedo has contracted obligations since August 1st, 1945, Now as part of the consideration above referred to Paul Kershaw, Jr., and Robert J. Azevedo agree to assume and pay any judgment or judgments which may arise from Court action or otherwise against John Azevedo or the Mills Winery during 1945, and up to and including date of actual transfer of the physical assets of the Mills Winery which will be the time that the United States Government issues to Paul Kershaw, Jr., and

Robert J. Azevedo a basic permit to operate said Winery.

The Commissioner determined, and the petitioners concede, that the net profit derived from the sales of wine was \$202,113.82, which amount is computed as follows:

Gross sales .....	\$693,114.80
Cost of sales.....	445,467.09
Gross profit .....	247,647.71
Total expenses .....	45,533.89
<hr/>	
Net profit .....	\$202,113.82

Robert and Kershaw paid John \$110,000 in installments during March, April, June, and July. The payments were made out of the proceeds of the sales of wine which were made during the months March through June. The sum of \$110,000 represented John's adjusted basis of the Mills Winery property plus \$10,000 for improvements; it also was the consideration stated in the purchase and sale agreement dated December 1, 1945. The payments to John were made on the dates and in the amounts set forth below:

March 22, 1946.....	\$ 5,000
April 17, 1946.....	10,000
June 24, 1946.....	45,000
July 4, 1946.....	50,000
<hr/>	
	\$110,000



On July 4, 1946, when the payment of \$50,000 was made to John, he was still on the premises of the Mills Winery.

Capital National Bank was repaid the loan made to John, \$440,000, out of the proceeds from the sales of the 1945 crush which were made in the months March through June, 1946. The sales were bulk sales in large quantities to Italian Swiss Colony Wine Company, Petri Wine Company, and Christian Brothers Wine Company. The invoices for the sales bore the name, "Mills Winery."

On March 4, 1946, Kershaw and Robert caused to be filed with the Secretary of State of California articles of incorporation of a corporation named Mills Winery. In the articles of incorporation the directors named were Kershaw, Robert Azevedo, and James M. Popper. Mills Winery, a California corporation, was organized on March 4, 1946. Mills Winery, a California corporation, is referred to hereinafter as Mills Winery, Inc., or as the corporation.

The directors held their first meeting on March 20, 1946. At this meeting by-laws were adopted, Robert was elected president of the corporation, and Kershaw was elected vice-president, secretary, and treasurer.

A special meeting of the directors was held on August 12, 1946, at the Mills Winery, the office of the corporation. At this meeting resolutions were adopted authorizing the following: Authorization

was given for the issuance of 20,000 shares of capital stock of the par value of \$100 per share. Authorization was given for the issuance of 10,000 shares to Robert and 10,000 shares to Kershaw. The vice-president was authorized to file an application to the Corporation Commissioner of California for a permit authorizing the issuance of 20,000 shares, and the issuance of 10,000 shares, each, to Robert and Kershaw. Also, the following resolutions were adopted:

\* \* \*

Whereas, the consideration to be paid to this corporation by the above-named persons for the issuance of said stock shall be in cash and other considerations other than money,

Now therefore, Be It Resolved, that upon the issuance of a permit by the Corporation Commissioner, Department of Investment, for the issuance of such shares, that Robert J. Azevedo and Paul Kershaw, Jr., shall pay to this corporation for the obtaining of a deed for the real property upon which the business is to be operated by this corporation is located, the sum of \$55,000 each or a total of \$110,000 in cash, and that further Robert J. Azevedo and Paul Kershaw, Jr., shall, in addition to the aforementioned sum, pay to one John Azevedo, an individual, who previously operated Mills Winery as an individual, the sum of \$109,500 each or a total of \$219,000, which is the actual cost expended for the recent improvements and installations on the property in which the business of this corporation is to be located, which said improvements at the above cost

were expended on behalf of John Azevedo and that for the promotion and development of enterprises to be operated by this corporation as so developed and promoted by Robert J. Azevedo and Paul Kershaw, Jr., is reasonably equal to the sum of \$735,500 for each person above named.

It Is Further Resolved that with the cash payments as herein mentioned and the defraying of improvement and construction costs as herein mentioned and the services rendered, the value of which has been fixed by this corporation, each of the above-named persons shall have contributed the sum of \$1,000,000 to this corporation, which will entitle them to the delivery by this corporation when the same is authorized of 10,000 shares each of the capital stock of this corporation.

On September 18, 1946, application on behalf of Mills Winery, Inc., for permission to issue 20,000 shares of capital stock, 10,000 shares, each, to Robert and to Kershaw, was filed with the California Corporation Commissioner. In this application, request was made to issue 13,500 shares (part of the 20,000 shares) in "promotional stock" (the value of which was fixed at some undisclosed sum in minutes of the corporation), by reason of the promotional services rendered by Robert and Kershaw, of which one-half, or 6,750 shares, each, were to be issued to Robert and Kershaw (part of the 10,000 shares to be issued to each) for their respective promotioal services. Such promotional stock, having a par value of \$1,350,000,

if authorized and issued, was to represent paid-in capital of the corporation.

On May 1, 1946, Treasury Form 698 had been executed on behalf of John Azevedo, doing business as "Mills Winery," and filed with the Federal Alcohol Tax Unit. In the Form 698, John Azevedo advised the Alcohol Tax Unit that he intended his basic permits to conduct a winery for the manufacture of wine and the distilling of fruit spirits to be discontinued as of the date similar basic permits and licenses were issued to Mills Winery, a California corporation.

On May 3, 1946, the corporation, Mills Winery, Inc., made application to the Federal authorities on Treasury Forms 1634 and 1639 for basic permits to produce and blend wine and to distill and sell distilled spirits. Attached to the applications was the following sworn statement:

Applicant's place of business will be purchased from John Azevedo, an individual and the present owner, when proper permits are received by applicant to engage in the operations of a Fruit Distillery.

A wine producer's and blender's basic permit, Form 1635, and a distiller's basic permit, Form 1640, were issued by the Alcohol Tax Unit of the Bureau of Internal Revenue under date of August 13, 1946, effective August 7, 1946. On about August 12, 1946, but before that date, the California State Board of Equalization issued to Mills Winery, Inc., a wine

manufacturers' license and a distilled spirits manufacturers' license. As of August 12, 1946, or a few days before, the corporation therefore had the basic Federal and state permits to engage in the business of manufacturing and selling wine and distilled spirits.

By a grant deed dated June 21, 1946, John Azevedo and Frances Azevedo, as grantors, granted to Mills Winery, a California corporation, all the real property upon which the Mills Winery premises and equipment were located. The deed was delivered by the grantors to a title company in the County of Sacramento, State of California, to be held in escrow for the benefit of the grantee, namely, Mills Winery, Inc. The escrow instructions filed by the grantor with the title company do not contain information regarding the delivery of the deed, nor the length of time the deed was to be held in escrow. The record in these cases does not establish how long the deed was held in escrow or the date when it was delivered to Mills Winery, Inc. The deed was recorded with the Recorder of Sacramento County on November 23, 1946, in volume 1294, at page 351, of his official records.

With respect to the issuance of the capital stock of Mills Winery, Inc.: On October 2, 1946, the California Corporation Commissioner granted permission to the corporation to issue 20,000 shares of capital stock (including the 13,500 shares of promotional stock), 10,000 shares, each, to be issued to Robert Azevedo and to Paul Kershaw, subject to the restric-



tion that the stock be placed in escrow. Thereafter, the corporation issued 10,000 shares of its capital stock, each, in the names of Robert and Kershaw but the stock was immediately placed in escrow with an attorney, Robert C. Burnstein. At the time of the trial of these cases, all of the stock was still held by Burnstein in escrow. The holding of the stock in escrow was in accordance with certain requirements of the laws of California relating to corporations and the issuance of corporation stock.

After the organization of Mills Winery, Inc., on March 4, 1946, various activities were carried on by Robert and Kershaw as officers and directors of Mills Winery, Inc., among which were the following:

On April 9, 1946, Kershaw, on behalf of the corporation entered into an agreement with certain individuals under which the corporation agreed to make distilled fruit spirits during the 1946 fruit season from fruit juice and pulp to be furnished by the individuals and to pay the individuals a part of the proceeds from the sale of the distilled fruit spirits. On April 9, 1946, the corporation did not have title to the winery property and equipment.

In April, 1946, Mills Winery, Inc., employed A. H. Becker as the managing employee to conduct the office affairs of the corporation. As such employee, Becker continuously, from April, 1946, to January, 1950, dealt with growers, wine manufacturers, distillers, fruit processors, wine brokers, and all persons interested in or connected with the fruit processing industry.

On May 11, 1946, and on May 23, 1946, Robert, as president of the corporation, entered into written agreements with Southern Pacific Company, a railroad company, whereby Southern Pacific, as licensor, granted Mills Winery, Inc., rights to private road crossings over tracks of Southern Pacific, "at grade," at certain locations. On May 11 and May 23, 1946, the corporation did not have title to the realty where the winery was located or where the rights of way covered by the agreements with Southern Pacific were located.

From June, 1946, to and including the month of August, 1946, certain improvements, additions and alterations, were being made by various general contractors, iron workers, designing engineers, and plant engineers relating to the winery premises and the equipment located thereon, all of which were paid for by the corporation after the date of its incorporation, such payment being made from funds arising out of proceeds from sales of wine made from the 1945 crush.

On August 8, 1946, the corporation filed with the collector of internal revenue, Form SS-4, Application for Employer's Identification Number. The preceding identification number had been issued to John Azevedo, doing business under the name, "Mills Winery."

Notifications of change in ownership of insurance policies and motor vehicles were made by the corporation during or subsequent to August, 1946.

At all times material, there was a single checking account in the Capital National Bank of Sacramento, California, for the business operations of the business carried on under the name of Mills Winery. During the period of August 1, 1945, to August 1, 1946, John Azevedo had the sole authority to sign checks and withdraw funds from this account. On and after August 1, 1946, Robert Azevedo and Paul Kershaw were granted permission to withdraw funds from the bank account on behalf of the corporation. All bank loans, warehouse obligations, and expenditures for improvements, alterations and additions made on the winery premises and on the equipment therein, that were paid prior to August 1, 1946, were paid by checks drawn by John Azevedo on the single bank account. All payments that were made after August 1, 1946, were paid by checks drawn by Kershaw on the same bank account.

The records of the Commissioner of Internal Revenue do not show that a partnership return of income, Form 1065, was filed by a partnership doing business under the name of Mills Winery for any period or for the period August 1, 1945, to March 1, 1946. In the individual income tax returns for 1946 of Robert, Paul Kershaw, and Irene Kershaw, no income was reported from the sales of wine made from the 1945 crush, which net income is involved in these cases, and no income was reported as the distributive share, respectively, of Robert and of Paul Kershaw of the earnings of a partnership named Mills Winery. The individual income tax return of

Paul Kershaw for 1946 reports receipt of salary from Mills Winery, Inc., in the amount of \$10,000. The individual return of Robert for 1946 does not report the receipt of any salary payments by the corporation.

A corporation income tax return, Form 1120, was filed for Mills Winery, Inc., for the taxable period beginning March 4, 1946. The return was prepared by National Accounting Service of Los Gatos, California. In this corporation income tax return, net income was reported in the amount of \$225,805.61. The return was signed by Kershaw as an officer of the corporation on May 7, 1947, and it was filed on May 15, 1947. In the return earned surplus and undivided profits were stated to be \$225,805.61, and the only officer reported as receiving compensation was Kershaw for whose salary a deduction of \$10,000 was taken. Also, in this corporation return inventory at the beginning of the taxable period was stated to be \$445,467.09.

An amended corporation return for the same fiscal period as the original return was executed on May 26, 1947, by Paul Kershaw. In this return net income was reported in the amount of \$203,432.29, earned surplus and undivided profits was reported in the amount of \$203,432.29, and a deduction of \$30,000 was taken for Kershaw's salary. Opening inventory was stated to be \$445,467.09 at March 4, 1946.

The figures representing the selling prices of the wine made from the 1945 crush and the expenses ap-



plicable thereto were included in the income and expenses which were set forth in the original return and in the amended return filed for the Mills Winery corporation for the fiscal period March 4, 1946, to March 3, 1947. The profits from the sales of wine made from the 1945 crush were "picked up" as profit of the corporation in its returns for the above period.

A corporation income tax return for the fiscal period March 1, 1951, to February 29, 1952, was filed for Mills Winery, Inc., the corporation. The balance sheet in the return, Form 1120, reported no outstanding capital stock at the beginning of the taxable period. The balance sheets in the corporation returns for the fiscal period March 4, 1946 to March 3, 1947, did not report any outstanding capital stock.

In the minutes of the special meeting of the directors of Mills Winery, Inc., on August 12, 1946, a resolution was adopted which provided, inter alia, that Robert and Kershaw were to pay to the corporation in cash \$55,000, each, or \$110,000 for the purpose of obtaining the deed from John and Frances Azevedo to the real property where the Mills Winery is located. The sum of \$110,000 was never paid to the corporation by Robert and Kershaw. A liability of \$110,000 owed by Robert and Kershaw was first reflected in the balance sheet in the corporation income tax return filed for the period March 1, 1951, to February 29, 1952, as an item of capital stock.

Mills Winery, Inc., is still in existence.



On October 17, 1946, Robert Azevedo sold all of his stock in Mills Winery, Inc., to Paul Kershaw, Jr., for \$50,000.

On February 26, 1952, Robert Azevedo executed and filed a consent extending to June 30, 1953, the time within which the income tax for the year 1946 might be assessed.

On January 22, 1952, Paul Kershaw, Jr., executed and filed a consent extending to June 30, 1953, the time within which the income tax for the year 1946 might be assessed.

On January 22, 1952, Irene Kershaw executed and filed a consent extending to June 30, 1953, the time within which the income tax for the year 1946 might be assessed.

The individual returns for 1946 of Robert Azevedo, Paul Kershaw, Jr., and Irene Kershaw were filed on March 7, 1947, March 15, 1947, and March 20, 1947, respectively.

The notices of deficiencies which have given rise to these cases were mailed by the Commissioner on May 13, 1953.

Title to the real property of the winery and to the improvements did not pass from John and Frances Azevedo to Mills Winery Corporation until sometime after August 12, 1946. John did not sell the wine inventory from the 1945 crush to Robert and Kershaw or to the corporation before the wine was sold.

Robert Azevedo and Paul Kershaw, Jr., in the agreement of December 1, 1945, agreed to buy the winery property and real estate as individuals. Under the agreement of December 1, 1945, it was agreed that on and after January 1, 1946, Robert and Kershaw would operate and manage the winery for John Azevedo until such time as they, the purchasers, should be able to make the actual purchase of the winery, and that Robert and Kershaw should receive as their salaries and compensation for their services the earnings of the winery business during the period of their management.

During the period January 1, 1946, to August 6, 1946, the net earnings of the winery business known as Mills Winery amounted to \$202,113.82, and these earnings were derived from the sales in the months March through June, 1946, of the wine made from the 1945 crush. These earnings represented, 50 per cent to each, or \$101,056.91 to each, compensation and salary to Robert Azevedo and Paul Kershaw, Jr., respectively, for his services in the operation and management of the business known as Mills Winery, and for their respective services in the making and selling of wine from the 1945 crush during the period January 1, to August 6, 1946; these net earnings were not the earnings of the corporation, Mills Winery, Inc.

Each petitioner omitted from the gross income reported in his and her individual return for 1946, an amount properly includible therein which is in ex-

cess of 25 per cent of the amount of gross income stated in the individual return.

The Commissioner determined that the earnings from the operation of the business known as Mills Winery for the period from January 1, to August 6, 1946, were taxable to Robert Azevedo and Paul Kershaw, Jr. He determined that the net profit from the operation of the Mills Winery business during the above-stated period amounted to \$202,113.82 and that 50 per cent thereof was taxable to Robert and to Paul in the amount of \$101,056.91, each. The Commissioner also determined that Robert was entitled to deduction for a short-term capital loss on the sale of 10,000 shares of capital stock of Mills Winery, Inc.

The Commissioner's determination of the amount of the net profit from the operation of the Mills Winery business for the above-stated period, as set forth in the statement attached to the notices of deficiency is as follows:

### Statement of Income

#### Mills Winery

Jan. 1, 1946 through Aug. 6, 1946

Sales .....	\$693,114.80
Cost of Sales.....	445,467.09
	<hr/>
Gross Profit .....	\$247,647.71
Total Expenses .....	45,533.89
	<hr/>
Net Profit .....	\$202,113.82

Distributable

Robert Azevedo .....	\$101,056.91
Paul Kershaw, Jr.....	101,056.91
	<hr/>
	\$202,113.82

In determining the amount of the short-term capital loss on the sale of 10,000 shares of capital stock of Mills Winery, Inc., in the case of Robert Azevedo, the Commissioner computed the amount of the loss in the following way:

Cost basis of 10,000 shares of Mills

Winery, Inc., capital stock acquired

by you on August 6, 1946.....\$101,056.91

Selling Price of stock on October 5, 1946    50,000.00

Short-term capital loss on sale.....\$ 51,056.91

Allowable deduction for capital loss

(limited to \$1,000 under provisions

of section 117(d)(2) of the Internal

Revenue Code) ..... 1,000.00

Capital loss on sale of stock claimed

on your return..... None

Decrease in gross income.....\$ 1,000.00

The facts which have been stipulated which are not set forth above are found in accordance with the stipulation.

## Opinion

The chief question is whether the net income from sales of wine which were made during the months March through June, 1946, the wine having been made from the 1945 crush, is taxable to Robert Azevedo and Paul Kershaw, Jr., as the Commissioner has determined, or whether the income is taxable to the corporation, Mills Winery, Inc. If it is determined that one-half of the income in question, \$202,-113.82, is the income of Robert and Kershaw in equal amounts, it follows that each of the petitioners, Robert, Kershaw, and Irene, omitted from the gross income which each reported in his and her return an amount properly includible therein which is in excess of 25 per cent of the amount of gross income stated in the return, and therefore the provisions of section 275(c), 1939 Code, apply and the deficiencies are not barred.

The evidence in this proceeding consists of a stipulation of facts, exhibits, and the testimony of Kershaw and Burnstein. Neither John nor Robert Azevedo testified or appeared during the trial of these cases. All of the evidence has been considered carefully, as well as the arguments of counsel for the parties. The facts which have been stipulated largely are facts which are involved in the theory of the petitioners. The respondent relies chiefly upon the agreement of December 1, 1945, between John, who is designated the seller, and Robert and Kershaw who are designated the purchasers. The respondent, too, relies upon the facts relating to the various steps



which were taken in organizing the Mills Winery corporation and particularly upon the dates on which the various steps were taken.

Petitioners contend that from about August 1, 1945, until about March 1, 1946, Robert and Kershaw were copartners, doing business under the name of Mills Winery, and that the activities of the copartners consisted in the purchase of grapes in the fall of 1945 and the making of wine from the crush in preparation for the sale of the wine in bulk on the open market in 1946; that on March 4, 1946, the corporation, Mills Winery, Inc., was organized and purchased from Robert and Kershaw the net worth of the partnership, acquired the partnership assets and assumed partnership liabilities; that the partnership assets consisted primarily of a wine inventory and that the liabilities were primarily those that arose from bank loans obtained to finance the 1945 crush together with the cost of several improvements to the winery which were made during the 1945 crush plus an obligation of \$100,000 to John Azevedo. The petitioners contend further that immediately after its incorporation, the corporation commenced corporate business activities and that Kershaw, as an officer of the corporation, sold the wine from the 1945 crush on behalf of the corporation, and therefore that the income realized from the sale of the wine was the income of the corporation rather than the income of Robert and Kershaw. The petitioners contend also that the deficiencies are barred. The corporation received from the Alcohol

Tax Unit of the Bureau of Internal Revenue the basic permits to produce wine and distill spirits, effective August 7, 1946. This date provides the explanation for the Commissioner's determination in the deficiency notices that August 6, 1946, is the end of a taxable period during which Robert and Kershaw earned income in the amount of \$202,113.82. The parties used the date, August 6, 1946, as a critical date and petitioners' argument relates, in part, to the period March 4, 1946, to and including August 6, 1946. The petitioners take the view that the corporation acquired an inventory of wine on March 4, 1946. Since the sales of the wine which is involved under this issue were made during the 4-month period, March through June, 1946, the petitioners contend that the sales were made by the corporation.

Upon thorough consideration of the arguments of petitioners' counsel and of the entire record, the contentions of the petitioners are found to be strained and seriously impaired by the absence of evidence to establish that what the petitioners argue took place actually occurred. Moreover, there have been established several facts relating to the organization of the corporation which militate against the contentions of the petitioners. The facts and circumstances which are adverse to the petitioners are set forth hereinafter. The entire record supports the determinations of the Commissioner and it is concluded that the total net income derived from the sales during the months of March through June, 1946, of the wine made from the 1945 crush was the income of

Robert and Kershaw in equal amounts of \$101,-056.91. This conclusion must be reached because of the facts relating to what was done. The theory of the petitioners is founded, largely, upon what might have been but was not done, as well as upon facts relating to a business which eventually was carried on by the corporation which had nothing to do with the sales of the wine which is involved.

The issue to be decided involves basically the principle that earned income is taxable to the person who earns it, and income produced by property is taxable to the person who owns the property at the time the income is produced. *Lucas v. Earl*, 281 U. S. 111. A tax cannot be escaped "by anticipatory arrangements and contracts however skillfully devised." It is true that a distinction is made between a gift or transfer of earnings by the person who has earned income or otherwise created the right to receive it and enjoy the benefit of it when it is paid, *Corliss v. Bowers*, 281 U.S. 376; *Helvering v. Horst*, 311 U.S. 112; *Helvering v. Eubank*, 311, U.S. 122, and income produced by property after the ownership thereof has been conveyed to another, *Blair v. Commissioner*, 300 U.S. 5. In these cases the above distinction has been taken into account and the facts have been scrutinized to determine whether the rule of *Lucas v. Earl*, *supra*, applies rather than the rule of *Blair v. Commissioner*, *supra*. Our conclusion is that the facts bring these cases under the rule of *Lucas v. Earl*, *supra*. Stated simply, the situation was as follows: John, the father of Robert, was en-

gaged in the construction business before and during 1945 and thereafter. He owned the Mills Winery property but he had leased it to a wine producer, Christian Brothers Winery, and he did not have the Federal and state basic permits to make wine and distilled spirits. His son, Robert, had become a winemaker by training and it appears that John was ready to set his son up in business but Robert had no capital. Under these circumstances John was willing to assist Robert and Kershaw to the extent of having them take over the operations and management of the Mills Winery, borrow the required capital to purchase grapes and finance the first crush, and allow Robert and Kershaw as their compensation for their personal services the entire net earnings of the Mills Winery during the period of their management. John was willing to sell the winery property and improvements to Robert and Kershaw for the adjusted basis to John which was, at the end of 1945, \$100,000. It was not inconceivable that the gross proceeds from the sale of the wine made from the 1945 crush would be large enough to repay the bank loans, the amount of which entered into the cost of the wine, and to yield net earnings of \$100,000 or more. Kershaw was a salesman and Robert was a winemaker. There was no written partnership agreement between Robert and Kershaw. Under the written agreement of December 1, 1945, with John, however, they were to operate the winery for John in consideration of the receipt of salary and compensation for their services.



The written agreement of December 1, 1945, is controlling. The agreement is clear and unambiguous. The agreement is a purchase and sale agreement in which John is the seller and Robert and Kershaw are the purchasers. The agreement provides that the purchasers shall operate and manage the winery beginning on January 1, 1946, until such time as the purchasers shall be permitted to receive in their name the basic permits which would enable them to operate the winery, i.e., manufacture wine and distilled spirits under Federal and state regulations. The agreement provided that until such time as the purchasers should be able to make the actual purchase of the winery, they should receive compensation for their services to consist of the earnings of the business during the period of their management. The agreement of December 1, 1945, with respect to the sale of the winery premises was an executory contract. The Federal and state basic permits to make wine and distilled spirits were not issued until August, 1946. Until that time the condition precedent upon which the actual sale and purchase of the winery depended did not come into existence. Although Robert and Kershaw caused a corporation to be organized on March 4, 1946, there was no written assignment by Robert and Kershaw of their interests in the agreement of December 1, 1945, to the corporation and there was no written evidence of assumption by the corporation of any of the obligations of Robert and Kershaw as purchasers of the real estate and improvements making up the winery premises under the written agreement of December



1, 1945. All that we have is the self-serving testimony of Kershaw that the corporation took over what is referred to as the winery business and the inventory of wine. The assertion of Kershaw that the sales of wine in the months March through June, 1946, were made on behalf of the corporation is not supported by any independent proof that this was a fact. For example, books and records of the corporation were not introduced in evidence. There was no bill of sale from either Mills Winery, the sole proprietorship, or from John Azevedo to the corporation of the inventory of the wine made from the 1945 crush. There was no sale of the wine inventory to Robert and Kershaw before the wine was sold and they could not convey the wine inventory to the corporation. Issuance of stock of the corporation was not authorized and issued until October 2, 1946, which was after the wine which is in question had been sold. The mere statement in the corporation income tax return for the period March 4, 1946, to March 3, 1947, which was prepared for the corporation that the corporation had an inventory in the amount of \$445,467.09 on March 4, 1946, is not competent proof that the corporation in fact acquired and owned the inventory of wine which was sold during March through June, 1946, from which sales the income in question was derived. Such statement in the original and amended corporation returns is self-serving.

The agreement of December 1, 1945, did not provide for the sale to Robert and Kershaw of an inventory of wine; the agreement related only to the

sale of the winery real estate and improvements. This conclusion is reached from consideration of all of the provisions of the agreement. It is noted that the agreement stated in paragraph 1 that "seller will sell to purchasers that certain winery known as Mills Winery, located at Mills Junction, California, together with all the assets pertaining thereto for the adjusted cost of said winery, plus all other of said winery, including inventory at cost price." But the sale agreement was an executory agreement, the seller to remain the owner of the winery, assets and inventory "until such time as the purchasers shall be permitted to receive in their name certain basic permits which will enable them to purchase and own said winery and operate the same \* \* \*." Furthermore, it was mutually agreed and understood by the parties "that unless the above-mentioned permits are issued in the names of purchasers on or before January 1, 1947, this agreement shall at the option of seller be declared null and void." It can only be concluded that under the terms of the agreement ownership of the inventory of wine produced from the 1945 crush remained in John Azevedo during the months when the wine was sold, and since all the wine was sold before the Federal and state basic permits were issued to Robert and Kershaw, or to the corporation, it cannot be concluded that Robert and Kershaw owned the inventory of wine which they contend they conveyed to the corporation as of March 4, 1946. It is held that the corporation did not own the inventory of wine which was sold in March through June, 1946. It is held, further, that the in-

ventory of wine which was sold was owned by John Azevedo when the sales were made.

Under the above holdings, the position of the petitioners amounts to an effort to have the earnings produced by the sales of the wine taxed to the corporation. Such condition cannot be sustained under the rule of *Lucas v. Earl*, *supra*; *Helvering v. Horst*, *supra*; and *Helvering v. Eubank*, *supra*. The corporation did not own the property—the wine—before the income derived from the sales thereof came into being. The rule of the *Blair* case does not apply.

The inventory of wine, which was owned by John Azevedo, was sold and the bank loans which he had obtained were repaid out of the proceeds of the sales; other expenses were paid out of the proceeds of the sale; and under the provisions of paragraph 3 of the agreement of December 1, 1945, Robert and Kershaw had the right to the net proceeds of the sales as their salaries for their personal services in managing and operating the sole proprietorship business of John Azevedo and in making and selling the wine produced during the period of management by Robert and Kershaw. It is presumed that Robert and Kershaw received, one-half each, the net proceeds from the operation of the winery business, in the total amount of \$202,113.82. Petitioners have not shown that they did not receive the income or that they did not have dominion and control over the income. There is no proof that all or part of the net earnings of the winery derived from the sales of the inventory of wine during March through June, 1946,

came into the possession of the corporation. For example, there was no bank account opened in the name of the corporation as of March 4, 1946. Furthermore, the authority to draw checks on the bank account of the winery business remained exclusively in John until August, 1946, and until then petitioners had no authorization to make withdrawals from the account. We do not have in evidence any checks of buyers of the wine in question made payable to the corporation. But even if the net proceeds from the sale of the wine had been paid to and come into the possession of the corporation, that would amount to no more than an anticipatory arrangement whereby the income in question, earned by Robert and Kershaw, was received by the corporation rather than by the individuals who earned the income, and such arrangement would not serve to relieve Robert and Kershaw from tax on the income.

There are facts in the Findings which relate to the operations of the corporation. At the time of the trial of these cases the corporation was still in existence and it apparently has carried on a business of its own. But these facts are immaterial in deciding the question before us.

It is unnecessary to point out other factors which are adverse to the petitioners because they are only cumulative.

The Commissioner's determinations are sustained.

It is unnecessary to consider an alternative contention of the Commissioner in view of the conclusions reached above.



Petitioners contend that the Commissioner had the burden of proof under the chief issue and they cite *Jacobs v. United States*, 126 F. Supp. 154. This contention of the petitioners is based upon the fact that the deficiencies were not determined within the normal 3-year period of limitations and the Commissioner is relying upon the 5-year period provided by section 275(c). We are satisfied that the respondent has met his burden of proof. Cf. *Leslie H. Green*, 7 T.C. 263, 277, *affd.* 168 F. 2d 994.

The petitioners contend that the deficiencies are barred because the agreements extending the period for assessment were executed more than 3 years after the filing of the income tax returns. The income tax returns of the petitioners were filed on March 7 and March 15, respectively, of 1947. The agreements extending the period for assessment to June 30, 1953, were executed, respectively, on January 22, 1952, and February 26, 1952. These dates were within 5 years from the dates of the filing of the income tax returns of the petitioners. The same question was presented in *May D. Hatch*, 14 T.C. 237, 243, *et. seq.*, reversed on another ground, 190 F. 2d 254. This Court held that since the taxpayer had omitted from gross income an amount which was in excess of 25 per cent of the gross income stated in the return for the taxable year, a period of 5 years from the date the return was filed was allowed for making assessment of the tax, and that since the agreements extending the period for assessment had been executed prior to the expiration of the 5-year period,



and since the deficiency notice was mailed to the taxpayer before the expiration of the extended period, the deficiency notice was timely and the period for assessment of the taxpayer's income tax liability had not expired. The question is controlled by *May D. Hatch*, *supra*. It is held that the deficiencies are not barred.

Decisions will be entered for the respondent.

Received April 27, 1956.

Entered May 7, 1956.

Served May 7, 1956.

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The Tax Court of the United States  
Washington

Docket No. 49896

ROBERT AZEVEDO,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, filed May 7, 1956, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1946 in the amount of \$65,020.05.

/s/ MARION J. HARRON,  
Judge.

Entered May 7, 1956.

Served May 7, 1956.

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The Tax Court of the United States  
Washington

Docket No. 49928

IRENE KERSHAW,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, filed May 7, 1956, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1946 in the amount of \$27,108.10.

/s/ MARION J. HARRON,  
Judge.

Entered May 7, 1956.

Served May 7, 1956.

The Tax Court of the United States  
Washington

Docket No. 49929

PAUL KERSHAW, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, filed May 7, 1956, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1946 in the amount of \$25,943.07.

/s/ MARION J. HARRON,  
Judge.

Entered May 7, 1956.

Served May 7, 1956.

The Tax Court of the United States

Tax Court Docket No. 49929

PAUL KERSHAW, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF  
TAX COURT DECISION

Taxpayer, the Petitioner in this cause by Robert C. Burnstein, Counsel, hereby files his Petition for Review by the U. S. Court of Appeals for the Ninth Circuit of the decision by the Tax Court of the United States rendered on May 7, 1956 (T. C. Memo 1956-109) No. 49929, determining deficiency in the Petitioner's Federal Income Taxes for the Calendar Year 1946, in the amount of \$25,943.07, and respectfully shows:

I.

The Petitioner in 1946, resided in Sacramento, California, and was married to Irene Kershaw. He filed an individual Income Tax Return with the Collector of the First District of California.

II.

**Nature of Controversy**—The controversies involves the determination as to whether or not net profits from the sales of wine during the months of March through June, 1946, is taxable in equal

amounts to the Petitioner herein and Robert Azevedo, or is taxable to a California Corporation, namely, Mills Winery, which was organized under and by virtue of the laws of the State of California, on March 4, 1946.

John Azevedo, the father of Robert Azevedo, prior to 1945, was the owner of certain real property and improvements upon which a winery was located and which had been leased by John Azevedo to persons other than the Taxpayer herein to operate and maintain said winery.

In July, 1945, the said John Azevedo discontinued his lease arrangement with others, commenced as a sole proprietor the operation of the winery on the land owned by him and did business under the firm name and style of "Mills Winery." He held all the necessary basic permits to engage in the business as a winery and distillery required by the various governmental authorities.

On or about the 1st day of August, 1945, John Azevedo agreed to sell the winery to the Petitioner herein and Robert Azevedo at an adjusted cost which oral agreement was later reduced to written agreements dated December 1, 1945.

Commencing August 1, 1945, Petitioner herein and Robert Azevedo conducted operations at Mills Winery in connection with the crushing of grapes for the manufacturing of wine and did the same as copartners. The copartnership borrowed money from the Capital National Bank at Sacramento, said loan



being arranged through the efforts of John Azevedo. The total capital necessary for the formation of the copartnership for the purchase of the grapes and the manufacturing of the wine was obtained from said Bank by way of a loan. The inventory, namely, the wine that came into existence from the 1945 grape crush was an inventory owned by the Petitioner and Robert Azevedo as a partnership asset and such inventory came into existence as a result of the partnership efforts of the partners buying grapes and making wine. The partnership completed the crush in December of 1945, finished the wine and proceeded to seek markets for the same in January and February of 1946.

The copartners then decided to change the organization under which they would be selling said wine in bulk to various other wineries and did on March 4, 1946, organize a California corporation, namely, Mills Winery. At the close of the partnership and the dissolution thereof, the partnership books and records were closed, a final partnership income tax return prepared and all of the assets and liabilities of the copartnership which included the wine inventory was sold, transferred and assigned by the copartnership to the corporation. During all this time, namely, from August 1, 1945, to August 6, 1946, the basic permits and other governmental permits and licenses required to engage in business as a distillery and/or a wine manufacturer, stood in the name of John Azevedo, the father of Robert Azevedo.

Application for the necessary permits had been made in the month of May, 1946, by Mills Winery, a California Corporation. At no time however did the corporation engage in the manufacturing of wine or distilling of spirits but merely proceeded to sell bulk wine which it acquired at a single instance on a single purchase from the copartners upon the dissolution of the partnership and the organization of the corporation by said copartners.

That during the operation of the copartnership from August 1, 1946, to March 4, 1946, and after March 4, 1946, to and including August 1, 1946, there was just one single bank account which was a commercial account at the Capital National Bank in Sacramento and this account was used for the business operations of the copartnership during its existence and for the corporation from March 4, 1946, to August 1, 1946.

That at all times from August 1, 1945, to August 1, 1946, John Azevedo, the father of Robert Azevedo, had the sole authority to sign checks and withdraw funds from the account but that all monies that were withdrawn prior to March 4, 1946 from said account were used to pay the obligations of Petitioner and Robert Azevedo as copartners and all monies withdrawn from said account after March 4, 1946, were used to pay the obligations of the corporation.

That after August 1, 1946, the same bank account continued but with the Petitioner and Robert Azevedo being authorized to sign checks thereon. All of the sales of the wine were made after March 4, 1946,

and were completed before July 1, 1946. All such sales were recorded as corporate gross profit in the books and records of the corporation and all obligations incurred after March 4, 1946, were recorded as corporate expenditures and were paid as corporate expenditures and appeared on the books and records of the corporation.

The corporation filed its Income Tax Return based upon the profit made from the sales of said wine during said period and paid its tax thereon.

During this period of time, namely, from and after March 4, 1946, to August 6, 1946, other corporate activities were carried on by the corporation through its officers and employees indicating corporate activity.

The Petitioner filed his 1946 U. S. Individual Income Tax Return on March 15, 1947, and he executed a consent fixing the period of limitation upon assessment of income tax on January 22, 1952. The Notice of Deficiency was mailed to Petitioner on May 13, 1953.

The Commissioner of Internal Revenue held that the corporation did not own an inventory of wine prior to the sale thereof and that proceeds from the sales of the wine was not corporation income but was earnings to the Petitioner and Robert Azevedo by reason of the terms of certain agreements dated December 1, 1945, this determination all contrary to the conduct and intent of the parties as expressed by their actions and conduct.

III.

The said Taxpayers being aggrieved by the Findings of Fact and Conclusions of Law contained in said Findings and opinion of the Court and by its Decision entered pursuant thereto desires to obtain a review thereof by the U. S. Circuit Court of Appeals for the Ninth Circuit.

/s/ ROBERT C. BURNSTEIN,  
Counsel for Petitioner.

Received and Filed June 25, 1956, T.C.U.S.

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Popper and Burnstein  
Attorneys at Law  
414 13th Street  
Oakland 12, California  
Telephone TEmplebar 6-4400

August 1, 1956.

Clerk, U. S. Tax Court,  
Washington 4, D. C.

Re: Paul Kershaw, Jr., Docket No. 49929  
Irene Kershaw, Docket No. 49928

Dear Sir:

Upon my return to my office after being away for approximately thirty days, I had an opportunity to re-examine the Petitions for Review that have been filed and served in the above-entitled matters.

I noted that in the matter of Irene Kershaw, Docket No. 49928, on Page "4" that there was a typographical error which I believe should be cor-

rected although the error when reading the entire Petition is obvious. On Page "4" there is contained in said Petition the following paragraph:

"That during the operation of the copartnership from August 1, 1946, to March 4, 1946, and after March 4, 1946, to and including August 1, 1946, there was just one bank account, etc."

This paragraph is in error as it refers to one date. The paragraph should read:

"That during the operation of the copartnership from August 1, 1945, to March 4, 1946 \* \* \*"

The error was obviously August 1, 1945, in place of August 1, 1946.

I noted likewise in the Petition for Paul Kershaw, Jr., Docket No. 49929, the same error appears on Page 4. A similar Paragraph on Page 4 of Paul Kershaw's Petition now reads:

"That during the operation of the copartnership from August 1, 1946, to March 4, 1946, and after March 4, 1946, to and including August 1, 1946, there was just one single bank account\* \* \*"

This paragraph should likewise read:

"That during the operation of the copartnership from August 1, 1945, to March 4, 1946, and after March 4, 1946 \* \* \*"

The obvious error of course was the dates should



be August 1, 1945, and not August 1, 1946. This error does not appear in the Petition signed by Robert Azevedo. It is correctly set forth on Page "4" of his Petition.

We therefore respectfully request that this letter be made part of the record which corrects the error which is obvious by changing the date in the paragraph hereinabove referred to from August 1, 1946, to August 1, 1945.

Very truly yours,

/s/ ROBERT C. BURNSTEIN,

RCB/fg

Encl.

(Affidavit of Mailing)

A copy of this letter was mailed to John Potts Barnes, Chief Counsel, Internal Revenue Service, Tax Court of the United States, Washington 4, D. C.

/s/ ROBERT C. BURNSTEIN,

Received and Filed August 3, 1956, T.C.U.S.

The Tax Court of the United States

Docket No. 49896

ROBERT AZEVEDO,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

Respondent.

Docket No. 49928

IRENE KERSHAW,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 49929

PAUL KERSHAW, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Wednesday, June 29, 1955

(Met, pursuant to notice.)

Before: Honorable Marion J. Harrou, Judge.

Appearances:

ROBERT C. BURNSTEIN, ESQ.,

Appearing for the Petitioners.

EDWARD H. BOYLE, ESQ.,

Honorable JOHN POTTS BARNES,

Chief Counsel, Bureau of Internal Revenue,

Appearing for Respondent.

### PROCEEDINGS

The Clerk: Docket 49896, Robert Azevedo and related cases. Please state your appearances, counsel.

Mr. Burnstein: Robert C. Burnstein, if the Court please, on behalf of the petitioners.

Mr. Boyle: Edward H. Boyle for the respondent.

The Court: You may proceed.

Mr. Burnstein: Your Honor, a motion has been filed by both the petitioner's counsel and the attorney representing the respondent to consolidate these matters, and during the course of this argument, your Honor, I will refer to the parties, and unless you request some interruption, I will use specific names, but I will do my best not to take too long in discussing these facts by getting too many parties in.

The Court: Let's find out one or two preliminary things. Is there any objection to a consolidation of these proceedings?

Mr. Burnstein: No, your Honor.

The Court: All right; where is the motion? The motion was filed, was it?

Mr. Burnstein: The motion was filed, your Honor, I believe Monday morning.

The Court: Motion to consolidate is granted. Now, we have the lead case, the case with the lowest docket number, Irene Kershaw, and that will be the name of the case. The year [3\*] in that case is 1946, only, I believe?

Mr. Burnstein: That is right.

The Court: And then in Docket No. 49939, we have Paul Kershaw who, I presume, is Irene's husband?

Mr. Burnstein: That is right, your Honor.

The Court: Docket No. 49896, Robert Azevedo. Who is Mr. Azevedo?

Mr. Burnstein: Your Honor, if I may take one moment of your time, Robert Azevedo and Paul Kershaw, Jr., are the taxpayers who are actually being assessed a deficiency. Mrs. Irene Kershaw is in this only because of her community nature of income as a wife of Paul Kershaw.

The Court: I understand that perfectly well. We go through that all the time. Who is Robert Azevedo?

Mr. Burnstein: Robert Azevedo is an alleged partner during a period of time from August 1 of 1945 to August 6, 1946, with Mr. Paul Kershaw, Jr.

The Court: What is the issue in these cases?

Mr. Burnstein: The prima facie issue, if the Court please, is whether or not during a period of time from March 4, 1946, to and including August 6, 1946, that a partnership consisting of Paul Ker-

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\*Page numbering appearing at top of page of original Reporter's Transcript of Record.

shaw, Jr., and Robert J. Azevedo conducted the sales of wine, of a California corporation incorporated under the laws of the State of California on March 4, 1946.

The question is whether or not these two gentlemen [4] during that period of time from March 4, 1946, to and including August 6, 1946, were engaged as copartners in the sale of wine or was this sale of wine being conducted by a corporation entity organized and existing under and by virtue of the laws of the State of California as of March 4, 1946.

The Court: The Commissioner has determined that the business was carried on by the partnership; is that right?

Mr. Burnstein: That is right.

The Court: Was there a partnership?

Mr. Burnstein: Yes, your Honor.

The Court: You agreed there was a partnership?

Mr. Burnstein: Yes, your Honor, not during that period. There was a partnership, as stipulated in the facts, from August 1, 1945, to March 1 of 1946, which is in the stipulation of facts as to the existence of a partnership. The Commissioner, of course, doesn't stipulate that the partnership terminated on that date. That is one of the factual problems that we will eventually bring before your Honor this morning, and in our briefs, with your Honor's permission.

The Court: Mr. Boyle, if you would like to file the stipulation of facts at this time, I would like to look at it.

Mr. Boyle: If your Honor please, we are filing these. I have several reservations, or rather, I want



to make clear several points which might be confusing otherwise.

The Court: I would like to go to this stipulation of [5] facts now, if it is all right with you.

Mr. Burnstein: Yes, your Honor.

The Court: What is your objection? There are certain paragraphs in the stipulation of facts about which you have objection, Mr. Boyle?

Mr. Boyle: Well, in Paragraph 11, your Honor, respondent doesn't mean to stipulate that this grant deed took effect on June 21. We merely mean to admit that it was executed, it was dated—we don't know when the date was, whether it was executed on the same date, but we want merely to stipulation—to enter a stipulation that it was executed.

It carries a date of June 21, and it was recorded in November.

Mr. Burnstein: Yes, your Honor. We are not asking the Commissioner to stipulate that the date that the deed bears actually conveyed the title. We believe, if the Court please, that when we are able to discuss this matter in our briefs, and even this morning, if you Honor wants on the question of law, that we would be able to convince the court, we hope, that that in itself is sufficient evidence to show the passage of title, but I am sure the Commissioner did not intend to stipulate that title passed on the 21st of June of 1946; is that correct, Mr. Boyle?

Mr. Boyle: That is correct.

Mr. Burnstein: I am sorry if I worded it in such a [6] way that it is confusing.

Mr. Boyle: We have one other reservation, or want to make clear one other point.

The Court: What is the next point?

Mr. Boyle: In Exhibit 3-C, which purports to be a partnership return running from August 1, 1945, to March 1, 1946, the exhibit attached is a retained copy that the petitioner had.

The Director of Internal Revenue has never been able to find that such a return was filed, and therefore, respondent is not in a position to admit that it was filed when its records do not so indicate. I notice that the copy filed carries no signature. Of course, normally, that means it is no return.

In this case, since it is supposedly a retained copy, that has not the significance it would on a filed copy, but I want to point that out too.

Mr. Burnstein: May I say this, if your Honor please? I can well understand Mr. Boyle's feeling. It wasn't until yesterday, if the Court please, that this matter was brought out. As a matter of fact, the proposed stipulation of facts prepared by the United States Commissioner says that this particular return was filed. This is the stipulation they submitted to me, that Exhibit 3-C was filed.

Mr. Boyle then called me and said to me that the [7] statement in his proposed stipulation saying that this Exhibit 3-C was filed was probably in error. I had never intended to have any witnesses to prove that this matter, that this return was mailed, and Mr. Boyle told me that since this was a matter that was brought up suddenly, since on June

23, his stipulation said it was filed, and I was under the impression that it was.

If it is necessary, we may take the deposition of the accountant who prepared this and said he mailed it: it was a physical impossibility to get it here because I thought it was stipulated to until yesterday afternoon.

Is that correct, Mr. Boyle?

Mr. Boyle: That is almost correct. I think it was the day before yesterday, but certainly it was short notice. I had asked the Director to ascertain whether such a return was filed, and in the meantime, I assumed it was since they had a retained copy, and I put it in my proposed stipulation.

I found from the Director that they had no such return, nor a record of it.

Mr. Burnstein: Your Honor will likewise notice that I didn't wish to take any advantage of Mr. Boyle in this regard, and I said in our stipulation, which refers to Exhibit C, that it was prepared for filing. I won't, under his statement, say that it was filed because he tells me the records do not show it. So I don't intend to say he is stipulating that it was filed, and we can get that evidence for what it's worth as to the making [8] and the preparation and the date of the mailing of the return that is Exhibit 3-C.

The Court: What is the materiality, Mr. Boyle, of the filing of the partnership return for the period August 1, 1945, to March 1, 1946?

Mr. Boyle: I don't believe there is any, your Honor. I have no thought that it is material, but I

did not wish to stipulate to something our records indicated was not so, and that is the only reason.

The Court: That is not my point in asking you that question. I have gone on to another thought. Does it mean something in this case whether a partnership return was filed or was not filed for a period ending March 1, 1946? Does that fact contribute something to an understanding of the issues presented?

Mr. Boyle: This is a factual issue which, brick by brick, will be built up, as a brick in a structure. It has no particular significance, I do not think.

The Court: Well, then, you have explained Paragraph 4 in Exhibit 3-C. I don't see why I should accept Exhibit 3-C unless I know what was done, and we will go back to that later, I guess.

Mr. Boyle: If your Honor please, in order to be completely fair with Mr. Burnstein, he believes that it is very important to his case, and I didn't wish to completely eliminate it. [9]

I did say that I would rather have it put in through the testimony of the accountant, and if he couldn't be here, to do it on deposition; leave the record open and take his deposition later, but it was attached to the stipulation of fact this morning and I thought I would then explain it to your Honor rather than——

The Court: Is there anything else you want to explain?

Mr. Boyle: One more thing. I notice that he does, the petitioner attaches the amended return of the corporation for the year March 4, 1946, to March 3, 1947, and of course, the amended return is not a



return standing alone. Therefore, I believe, to complete the record, we better put in the original, too.

Mr. Burnstein: Yes, your Honor.

The Court: Yes; you would have to do that. I only have one amended return, and that relates to a fiscal year ending March 3, 1947. You were just referring to one?

Mr. Boyle: I merely want to put the original of that return with it.

The Court: Will you bear with the Court a few minutes? I will have to take a recess because of a long distance call.

(Short recess taken.)

The Court: Court is in session again. I will have [10] to go ahead without the Clerk. Will you resume, please, Mr. Boyle? I was asking Mr. Boyle about these matters. I will receive all these exhibits later.

Have you any other problem about the stipulation?

Mr. Boyle: That is the only thing I have about the stipulation of facts, your Honor.

The Court: Mr. Burnstein, you may proceed and tell us what the problem in this case is.

Mr. Burnstein: Yes, your Honor.

#### OPENING STATEMENT ON BEHALF OF THE PETITIONER

Mr. Burnstein: If I may give you a brief history, which will assist the Court in eventually determining the factual facts in the controversy, in July of 1945, a man by the name of Mr. John Azevedo,



who prior to that time, had been the lessor of certain premises which had been improved and constructed for the purposes of manufacturing wine, and a fruit distillery which we laymen, as far as the wine business is concerned—call it a winery, had been leasing these premises to various wine manufacturers, such as Christian Brothers and other organizations.

The Court: Excuse me, please. Your statement isn't clear. Didn't Mr. Azevedo own the property, and was he the lessor or was he a lessee, and then did he sublease?

Mr. Burnstein: He was a lessor, your Honor. Mr. John Azevedo, who is the father— [11]

The Court: Well, he owned land somewhere. Where was that?

Mr. Burnstein: In Sacramento County, in Mills Junction, substantially is the address.

The Court: All right.

Mr. Burnstein: Mr. Azevedo is the lessor and leased this land in July of 1945, approximately in July. But then in the month of July of 1945, he terminated the various relationships of landlord and tenant and lessor and lessee that he had with others, applied for and did receive from the Federal Alcohol Tax Unit, and from the State of California, the necessary basic permits to permit him as an individual to engage in the manufacturing of wine and the distilling of fruit spirits.

He then made arrangements as an individual with the Capital National Bank in Sacramento, California, to borrow approximately \$440,000 in order to

finance the crush—that is, in order to obtain money necessary to go out to the individual farmer, grape grower, buy the grapes, bring them into the winery, crush them and manufacture them into wine, fortified also by distilled spirits.

In August of 1945, which is prior to the actual day when the grapes are physically crushed, but when the grapes were being purchased, and when a loan had been obtained from the Capital National Bank, Mr. John Azevedo entered into [12] certain oral agreements with Robert Azevedo and Paul Kershaw, Jr., the two taxpayers now before this Court.

As a result of these agreements on August 1 of 1945, Mr. Robert Azevedo and Paul Kershaw, Jr., entered into and operated a copartnership, taking care of the crushing problems and the purchase of grapes; that is, the physical and mechanical things necessary to bring grapes into the winery and to have them crushed by the various methods of the grape manufacturing.

On December 1, 1945, or approximately thereto, the grape crush season had been completed in California: that is, all the grapes were finished, crushed and in the process of being finished up for final wine. At that time, Mr. John Azevedo said to his son, Robert J.—who incidentally was a wine maker, educated at the University of California, the Agricultural College for this purpose, and likewise Mr. Kershaw, who was doing some of the selling, the negotiations for the sale of the wine when it came into being, said, “I want something in writing to reflect what your obligations to me are.”

On December 1 of 1945, two agreements were entered into which are Exhibit 1-A and 2-B to the stipulated facts. Thereafter, through December of 1945, and through January of 1946, and through February of 1946, Mr. Robert J. Azevedo and Paul Kershaw, Jr., proceeded to do those things necessary in the trade, what is commonly called "finishing." The wine [13] sediment had to be removed and they had to be tested and other things, and also negotiations were being made for various sales that had not been consummated, but since the wine was coming into being, ready for sale, these things were being done.

On March 4 of 1946, a California corporation was organized under and by virtue of the laws of the State of California, which is still in existence, and operating as a California corporation. On March 4 of 1946, the corporation was organized, and it then sold the wine to various buyers.

It is stipulated that all the wine of the 1945 crush was sold after March 4, 1946, and it is stipulated that all monies that came were in a single bank account, and all expenditures that were incurred by the corporation, and all monies that were spent for improvements were made out of this single bank account.

So that your Honor can understand this single bank account, may I please explain because it is a stipulated fact, and it is important, I believe, to the Commissioner's position, and I believe ours as well.

When Mr. John Azevedo had entered into this

agreement with Robert and Paul Kershaw, Jr., in August of 1945, and they commenced doing business as copartners, Robert and Paul didn't have the necessary permits from the federal government to engage in the manufacturing of wine or the distilling of fruit spirits.

That permit was in the name of John Azevedo; no [14] question about it. However, we will discuss this later on in our argument when your Honor wishes it.

Mr. Azevedo had the bank account; that is, John had a bank account in his name alone, and it was in the Capital National Bank. The monies that were deposited in the bank account prior to March 4 of 1946, came only from loans from the bank. That is, there was no money coming in because no wine was sold until after March 4 of 1946.

Any monies that were withdrawn, any monies that were withdrawn from this bank account from August 1 of 1945 to August 1 of 1946, was only upon the signature of Mr. John Azevedo. After August 1 of 1946, Mr. Paul Kershaw, Jr., and Mr. Robert J. Azevedo were given the authority to draw checks and checks were drawn.

The corporation didn't have any basic permit to manufacture wine nor to distill fruit spirits until August of 1946, August 7. However, the corporation, we contend, did sell wine from March 4, 1946, to and including June 30 of 1946; on or about the 30th day of June of 1946 all of the wine was sold that came from the crush of 1945.

Now, from this single bank account all the part-



nership obligations were paid and from this same bank account all the corporate obligations were paid. All the monies went into this same account and it remained intact except for certain payments that were made to Mr. John Azevedo for corporate [15] obligations which are stipulated to.

During the months of June, July and August certain obligations were incurred for the improvement of the winery premises. This is before the basic permits were obtained in the name of the corporation for the distilling and wine manufacturing.

These obligations were paid by the corporation from this single bank account. The books of the corporation reflected this. Now, when the corporation was organized, it had an opening inventory of \$445,600. That was the same closing inventory of the partnership on March 1 of 1946. The corporation then had the same opening inventory as the copartnership had as a closing inventory.

The partnership, if the Court please, lasted from August 1, 1945, to March 1, 1946; from the return and from the evidence, I believe that we have produced, and the corporation went into existence on March 4 of 1946.

Thereafter, of course, the corporation continued to sell all the wine and all the monies came into the single bank account. On August 7, 1945, the basic permits were issued to the California corporation.

May I just mention this? On June 21, 1946, a deed dated June 21, 1946, was delivered by Mr. John Azevedo to the title company, but it was recorded in November.



In April of 1946, which is likewise an exhibit to our [16] stipulation of facts, the corporation entered into agreements with others in connection with fruit distilling. In May of 1946, likewise which are exhibits to our petition, the corporation entered into licensing agreements with the Southern Pacific Railroad Company in connection with crossings at various grade tracks, which are attached, or by reference, attached to our exhibit.

Mr. Al Becker, which is likewise stipulated to, was employed by the corporation as office manager in April of 1946 and continuously, as it is stipulated to, dealt with, as said employee, until 1950, with all growers, manufacturers, distillers and other persons interested in the fruit processing industries as such an employee.

In essence that is the history. Boiled down to its ultimate facts, that is it. There are many ramifications that Mr. Boyle might want to discuss. The corporation, incidentally, is still in existence. It had stock issued in accordance with the permit issued by the Commissioner of Corporations of the State of California. That stock was not issued until October of 1946. The actual taking over of the distilling and the manufacturing of wine as distinguished from the sale of wine, which is not a basic permit might, or probably didn't come until the corporation received its basic permit to carry on the 1946 crush, which is not a question before this Court. I mention that only for the sake—— [17]

The Court: What was that date?

Mr. Burnstein: The commencement of the 1946 crush, your Honor? I would say the 1946 crush started around September of 1946, when the grapes were about ready for crushing. During all this period of time when the grapes which had been reduced to an inventory and created a wine inventory, this California corporation did sell the wine. It is stipulated in the statement of facts that the monies came into the single bank account, and the obligations were paid from the corporate funds.

We respectfully believe that in essence is a short history as to the background in this case.

The Court: Thank you. Mr. Boyle?

#### OPENING STATEMENT ON BEHALF OF RESPONDENTS

Mr. Boyle: If your Honor please, if we back into this, it will also take on a different perspective. The corporation did file a corporate return for the period March 1, 1946, to March 1, 1947, and the three individuals who are taxpayers here, Robert Azevedo, Paul Kershaw, Jr., and Irene Kershaw, filed individual income tax returns for the year 1946.

The Commissioner has taken the position that the income reported by the corporation, that part of the income reported by the corporation which came from sales made between March 1, 1946, and August 6, 1946, should be the income of the three individuals. [18]

The Court: You mean as members of a partnership?

Mr. Boyle: Probably, yes. The theory, of course, is that John Azevedo, the father, was the only per-

son that had authority to do anything, and the income was really his, but since, under the contract in writing with these two young men, since the contract said they were to manage and operate the premises for him and all profits would become their salary, actually it goes to him and then comes right back out and becomes the income of the individuals.

That is the theory of the Commissioner's case. They were operating as a partnership and we believe they continued to do so. Of course, the facts are entirely confused and mixed. During the period March to August of 1946, the Commissioner takes the position that the corporation was in being, but only just barely alive. It was not actually functioning and it had no authority to do any of these things, and actually didn't become alive until August.

The Commissioner treats it as a valid legal corporation after August, and concedes that all income thereafter belonged to the corporation, but it is that period prior to August of 1946 that we are talking about here, and it is the income during that period that is in issue.

Some of the facts that I might point out——

The Court: Where does this point about the existence of a partnership come in to the respondent's theory, if at all? [19] You say that the whole issue here relates to the period May 1, 1946, to August 1, 1946. That is a period of just three months?

Mr. Boyle: That is true.

The Court: And you say that during those three months there was income from a winery.

Mr. Boyle: Actually four months; from March to August.

The Court: Well, I have down here May—is it March or May?

Mr. Boyle: March 4, that is the day the corporation was incorporated under the laws of California.

The Court: March 4, 1946, to August. That is five months.

Is it your view that during that five-month period there is some income derived from a winery business; is that right?

Mr. Boyle: Actually, it is more specific than that.

The Court: What is it?

Mr. Boyle: It is stipulated that it is the income from the 1945 crush.

The Court: We will just call it then the income from the 1945 crush. And is it your position that that income from the 1945 crush is the income of John, or is it the income of a partnership?

Mr. Boyle: The income of a partnership, but it can [20] only become that way by virtue of going through John in accordance with their written agreement.

The Court: Why is that?

Mr. Boyle: In the written agreement of December, it says, "I will sell to you," the two young men. "at adjusted cost," which is the \$100,000—"the premises here, together with the wine inventory at a price of approximately \$440,000, which represents my indebtedness to a bank in Sacramento, in order to get the crush into the winery."

It further states: "Nothing will pass, not title to



anything will pass until the young men get the basic permits necessary to operate." That is the basic permits from the Federal Alcohol Tax Unit and the State Board of Equalization.

It states, however, that for their salary during all this period, they shall receive the profits that accrue in the interim. The only profits that accrue between that point, December of 1945 and August of 1946, result from the sale of this 1945 crush, and the Commisisoner concedes that the young men operated as a copartnership until March, as does the petitioner, but the Commissioner takes the viewpoint that it continued to operate until August for a number of reasons.

First of all, no basic permits were ever acquired by anyone except John, the father, and his ran from July of 1945 until August of 1946.

In August of 1946, the corporation received [21] the permits necessary from the federal and state authorities. They had made application, it is true, in May, but they were not granted the necessary permits to do business until August.

On that specific point, the Commissioner takes the position that no one had the right to sell this wine except the person with a permit, and only the father John had that. but of course, he was under contract with the young men.

The Court: That is a very important point. I want you to amplify that. No one had a right to sell the wine except the holder of the permit.

What is your authority for that?



Mr. Boyle: We say that under Title 27, United States Code, Section 203 (b) 12, which is under the Federal Alcohol Administration Act——

The Court: What does it provide?

Mr. Boyle: “It shall be unlawful except pursuant to a basic permit issued under this Act by the Administration, to engage in the business of distilling distilled spirits producing wine, rectifying or blending distilled spirits or wine or bottling or warehousing and bottling, distilled spirits or (2) for any person so engaged to sell, offer or deliver for sale, contract to sell or ship in interstate or foreign commerce, directly or indirectly or through an affiliate, distilled sipirits or wine so distilled produced, rectified, blended or bottled or warehouse and bottled”—— [22]

The Court: Where is the “unless.” I am waiting for the tag line on that.

Mr. Boyle: That is true, your Honor. That is the purport of this.

The Court: Unless the person has a special license?

Mr. Boyle: That is correct, except pursuant to a basic permit; that was the beginning sentence.

The Court: Issued under that act by the federal government?

Mr. Boyle: Yes.

The Court: In this business, does there have to be a state permit as well as a federal permit?

Mr. Boyle: There does, your Honor. Of course, I am not going to press down on that point.

The Court: Well, I want to get the whole picture.

Mr. Boyle: I understand there is, yes.

The Court: And John had the state permit as well as the federal permit?

Mr. Boyle: That is my understanding, yes.

The Court: Is it stipulated?

Mr. Boyle: Yes; we stipulated that, that he had the only basic permits that were in existence until August of 1946, and that included the state permits as well.

Mr. Burnstein: That is right.

The Court: Your theory is that proceeds from any [23] sale have to go to the holder of the permit, who is John?

Mr. Boyle: That is one of our reasons, yes, for believing that the income was his, and then to these young men.

The Court: They may have received it directly, but he would receive it constructively?

Mr. Boyle: Yes, your Honor.

The Court: They would receive it as compensation for services. You see, I don't see where a partnership gets into this. Maybe it doesn't make any difference, but if the income should be regarded as belonging to the holder of the permit, the holder of the permit is an individual and if some individuals perform some services and do some work in the business—unless there is this:

Is it contended that there is a partnership with John?

Mr. Boyle: No, your Honor, it is contended that

under their agreement of December, he said that "you shall operate and the profit shall be yours as salary," so if you put it on John's income, it would come right back out as expense.

We are trying to give effect to this written agreement of December, 1945.

The Court: What exhibit is the written agreement?

Mr. Boyle: 1-a and 2-B.

Mr. Burnstein: Your Honor, while this is still fresh [24] in your mind, may I make—without interrupting Mr. Boyle—make a short answer to some of these matters that he has just discussed?

The Court: You will be given an opportunity in just a minute when he finishes his statement.

Mr. Boyle: In addition, it is stipulated that the only bank account was a continuous one which started with the father back in 1945, only he had authority to draw checks and that bank account the young men took over for their partnership, but only he had authority to draw anything out of it, and that continued to exist after the corporation was formed in March and June and in July, and not until August did anyone other than the father John Azevedo have authority to withdraw from that bank account.

All the profits we are talking about from this wine crush went into the bank account, and all expenses came out by checks drawn by the father. So there stands the father with his basic permit and the only authority to act, but agreeing under a

written contract with the young men that the profits are theirs.

In March the young men did form a corporation. That is all they did. Actually, there was no request for the issuance of stock until September, and there was no stock—the State Corporation Commissioner didn't grant authority to issue stock until October, and it was not until August that the [25] corporation filed with the Collector of Internal Revenue Form SS-4, application for employer's identification form. The preceding identification number had been issued to John, which they need, if they have employees, and it was not until subsequent to August that notification of change in ownership of insurance policies and motor vehicles were made by the corporation, and there is nothing in writing or nothing in existence to show how title to any of these premises, the real property or the winery got out of the hands of John Azevedo, the father, into the corporation until November of 1946, when the grant deed was recorded in Sacramento County.

It is true that the grant deed carries a date June 21, but there is no evidence to show when it was put into escrow or when it was delivered. It may have been in the hands of John all that time. We don't know that, but of course, by June 21 the period is almost up anyway because it is stipulated that all these profits accrued prior to June, although we keep talking of August of 1946.

But all the profits accrued between March and June of 1946, so even if you give effect to the grant deed as of June 21, we have only got nine days



left that we would be talking about anyway, and there is no other document to show that title passed from the father to the boys, or the corporation.

Of course, as it actually turned out, the basic permits were never applied for by the young men, as it was set [26] out they should do in the written contract of December.

They went ahead and formed this corporation. They got it started and the corporation applied for basic permits, but the corporation really had no life, is our contention, until August. Apparently, the facts are confused. They were doing things in the name of the corporation, although the invoice headings and all their letterheads just said, "Mills Winery."

The father used that name as a sole proprietor. The boys used that name as a partnership and the corporation used it later, but during this interim period of confusion, from March to August, apparently the boys were doing some things as a corporation and some things not.

But our contention is that the income rightly belongs to the boys because the corporation was not alive enough, although it was a factor in a slight sense, it was not alive enough to say that the income belonged to the corporation.

It is like Holmes said in *Lucas v. Earl*; you have got to leave the fruit to the tree on which it grows, and we think that during that period the boys, through the father, were earning this income.

The Court: So the question here is whether income earned during the period March 4, 1946, to



August 1, 1946, is income of these three individuals or is income of the new corporation? [27]

Mr. Boyle: That is right.

Mr. Burnstein: That is right.

Mr. Boyle: Shall I continue?

The Court: Why do you pick on the date, March 4?

Mr. Boyle: They went down to Sacramento and asked for a charter for the corporation.

The Court: And the petitioner claims that the income is taxable to the corporation right from the day a charter was issued? Was it issued on March 4?

Mr. Boyle: Yes, it was. They say the income belonged to the corporation on and after that date. The Commissioner says, no, not until August 6 which is the day the corporation received its basic permit to operate.

The Court: August 6?

Mr. Boyle: Yes; did the corporation become full fledged.

The Court: On August 6 your point would be that the corporation began to do business?

Mr. Boyle: That is right.

The Court: Began a corporate existence from March 4, but it wasn't actually carrying on this business until August 6; is that your position?

Mr. Boyle: It had an existence in part. It had no stock out; it had no title to anything.

The Court: Just a shell corporation? [28]

Mr. Boyle: Just a shell, yes. It owned nothing. All that existed so far as the Commissioner is con-

cerned, is a charter of incorporation, although it will concede that certain acts were being carried on in the name of the corporation, apparently by the young men.

The Court: Even before they had any stock?

Mr. Boyle: Yes.

The Court: Of course, we understand how those things are done. I suppose, Mr. Burnstein, the Azevedos are Italians?

Mr. Burnstein: Portuguese, your Honor.

The Court: And how old was John Azevedo in 1945?

Mr. Burnstein: John was 56, your Honor.

The Court: Well, he wasn't an old man. He was just middle-aged.

Mr. Burnstein: Yes.

The Court: About how much land did he own up there at Mills Junction?

Mr. Burnstein: That amounts to approximately, I believe, three acres.

The Court: That is not very much.

Mr. Burnstein: No, your Honor.

The Court: Was there a building up there?

Mr. Burnstein: Yes, your Honor. The premises—and I use that in this respect: It had a wine-making chemist [29] building on it, with all the necessary paraphernalia required to make wine. It had the vats, it had a bonded warehouse, it had the crushing machines, the fermentation tanks.

The Court: Well, that sort of equipment doesn't take up too much room. What did he have, three or four small buildings?

Mr. Burnstein: Oh, yes, your Honor, many more than that, they were spread all over.

The Court: What was this winery called when he leased it?

Mr. Burnstein: The winery was run by Christian Brothers, and I don't know what they called it at that time.

Pardon me, if I may. I may ask Mr. Kershaw, who is in the courtroom. Do you know, Mr. Kershaw?

Mr. Kershaw: Christian Brothers Winery.

Mr. Burnstein: They are manufacturers. Your Honor probably might be familiar——

The Court: I have been in Napa Valley, and I have gone by the place called Christian Brothers Winery; is that the one?

Mr. Burnstein: Yes. Well, when you say that one, it is the same organization.

The Court: It is the same organization, and they probably lease various places?

Mr. Burnstein: That is right. [30]

The Court: All right. This was a place leased by the Christian Brothers Winery, and Mr. Azevedo took it back; the lease came to an end or the lease was terminated, and he decided to operate it himself, and he then went into the business of making wine, no doubt Sherry and Port and fortified wines?

Mr. Burnstein: That is right, your Honor. That was his intention until this arrangement with his son and Mr. Paul Kershaw.

The Court: How old was his son in 1945?

Mr. Burnstein: His son in 1945 was in his early twenties.

The Court: How old is Mr. Kershaw?

Mr. Burnstein: Mr. Kershaw was 32, your Honor.

The Court: I would be glad to hear any testimony that might throw more light on this, since Mr. Kershaw is here.

Mr. Burnstein: Your Honor, I don't think it is necessary because I believe—I have no objection, that is why I had him here, if it is necessary and if your Honor would like him to testify.

I respectfully submit this, your Honor, if I may make a few short answers to Mr. Boyle's statements.

First of all, Mr. Boyle has not given your Honor the complete picture on the Federal Alcohol Administration Act, and [31] I don't think he did it intentionally because I think this might be the first opportunity he has had to become involved with the Federal Alcohol Administration in their regulation of wineries.

There are three types of permits, not just one basic permit. First, there is what is called a fruit distiller's permit, which is under the same act that Mr. Boyle referred to.

Secondly, which is a separate piece of paper and separate type of application, called a manufacturer of wine, a winery permit.

Third, is the type of permit which is called a wholesaler of wine. Now, Mr. Boyle takes this major premise, and we respectfully submit that it is highly untenable, and the cases that we have previously

given the Commissioner are contrary to their contention and that is this:

The cases have held, and the regulations with the Federal Alcohol Administration have so decided, that if a particular person, such as a corporation in this case—let's say Mills Winery, obtained a total bulk wine from one seller, at one instance, the sale to many, many different people does not require a basic permit.

You must be engaged in the business of buying for resale which must be the habitual and continuous practice of going out and buying and selling, and it doesn't require a [32] basic permit when you buy 600,000 gallons, and then you just sell it to 35 different people; no basic permit under the Act, and it is that specific.

The Court: You call that a wholesale operation?

Mr. Burnstein: Yes, your Honor.

The Court: I thought you said there was such a thing as a wholesaler's permit?

Mr. Burnstein: There is, but there was a permit in the name of John, but the position that Mr. Boyle takes is that since there is no permit, all of this is illegal; nobody can do it but John.

The Court: No.

Mr. Burnstein: I thought that is what he said.

The Court: The point, Mr. Burnstein, is this: We are concerned here with taxable periods.

Mr. Burnstein: Yes, your Honor.

The Court: And if taxpayers carried on their business operations without being aware, without being sufficiently aware of the need for a certain



kind of timing in order to make the ending of the tax period for one taxpayer perfectly clear, and the beginning of the taxable period for another taxpayer perfectly clear, then, of course, he is subject to some determination by a tax official, which is made just for the purposes of taxation.

Mr. Burnstein: Yes, your Honor. [33]

The Court: Some taxpayers will accept those determinations; sometimes they are contested. Here you have some income for a three-month period. Why is it so vital to you whether you accept the Commissioner's determination or not?

Mr. Burnstein: Why is it so vital?

The Court: Yes. The taxpayers, these people carrying on a winery business up in Napa, did they have an accountant? Did they have a tax adviser, or did they——

Mr. Burnstein: What people, your Honor?

The Court: The Azevedos.

Mr. Burnstein: They were in Sacramento, your Honor.

The Court: All right; while they were getting organized, so to speak for this business, the Senior Azevedo had leased property at the Christian Winery?

Mr. Burnstein: Yes.

The Court: And he decided to go into the wine-making business and use this winery?

Mr. Burnstein: He was willing to set his son up in business; perhaps that is why he terminated the lease to Christian Brothers winery; the boy was getting out of University of California. He had pre-

pared to go into the wine-making business; the father had a winery and the father said, well, now, take this over and go into business and get Kershaw to go into it. [34]

How old is Mr. Kershaw?

Mr. Burnstein: He was 32 at that time, your Honor.

The Court: And Mr. Kershaw was older than Mr. Azevedo's son?

Mr. Burnstein: Yes, your Honor.

The Court: Had Mr. Kershaw had experience? Was he an experienced man?

Mr. Burnstein: Yes, your Honor.

The Court: Well, for some reason or other, the owner of the property decides that the business will be operated on that piece of property. How was John Azevedo to get anything out of that? Was he to be a stockholder of this new corporation?

Mr. Burnstein: No, your Honor.

The Court: Was he to lease the property to the corporation?

Mr. Burnstein: No, your Honor. He was selling.

The Court: He deeded the property?

Mr. Burnstein: That is right, your Honor, and he was paid.

The Court: He sold the property?

Mr. Burnstein: That is right.

The Court: Is that stipulated?

Mr. Burnstein: That is in the stipulation.

The Court: How much did he sell the property for? [35]

Mr. Burnstein: \$100,000, and at an adjusted cost of \$10,000; \$110,000.

The Court: So in the process of arranging things, there are several things done that run into the realm of taxes, and unless people do these things with the help of an accountant and a tax advisor at the time, it is quite easy for timing to be such that it isn't easy for the agent to determine where the tax period for one taxpayer ends and the tax period for another taxpayer begins.

These situations are all the creation of the taxpayer. What is there about this determination that is so unacceptable to the taxpayer?

Mr. Burnstein: Well, first of all, when you say "unacceptable" to the taxpayer, we respectfully believe that the position of the Commissioner is erroneous on all the facts that have been stipulated to, and the law that has decided cases such as these.

Secondly, to be very realistic about it, the difference in the tax is \$118,000. That is one of the things your Honor asked why they are so concerned; there is \$118,000 difference for those four months, and we respectfully believe, forgetting about the dollars and cents problem—that, of course, is the material problem on the eventual payment, but looking at this purely upon the facts and the position that the Commissioner has taken, we believe that their position can't [36] be sustained.

I honestly believe, your Honor, that when we have an opportunity to brief this, I think that I will be able to submit to your Honor cases of similar type, not within wineries but cases of what we call corpo-

rations, as they say, with a lot of meat on their bones, that are almost identical to a situation like this where the Court has upheld the taxable situation to the corporate entity and not to some alleged partnership.

I say that for this reason also, your Honor, and I want to show the inconsistency of the government's position on this, just as an academic question which has become a very important thing.

We have stipulated that this was a partnership from August 1, 1945, to, we say, March of 1946; the Commissioner says to August of 1946. But in the next breath they say this to your Honor, and your Honor asked the question:

Do you mean to say that the only person that has a right to sell this wine and a right to the income would be Mr. John Azevedo because he has the basic permit?

Well, in one breath they are saying this. For what it's worth I can give you cases that bring out this a little clearer, your Honor, if your Honor wants them. In one breath they say the corporation had no basic permit; therefore, no bones, no flesh on the corporation, but we are going to recognize the partnership, although it had no basic permit [37] because that had not too many bones or flesh on it, but we are going to give effect to this agreement of December 1 and August of 1945.

I honestly say this, your Honor, that the position is inconsistent. It has been held in these cases—and *Morrissey vs. United States* is one of the most interesting cases, that even when there is a corpora-



tion that requires a permit to engage in business—I am not saying that we needed one in this case, but let's assume that we did—even when a corporation needs a permit to engage in business, if it does those things in connection with the purpose for which the corporation is organized, the failure to have a permit shall not permit the courts to disregard the corporate entity.

The Court: The Morrissey case doesn't involve any permit, did it?

Mr. Burnstein: No, your Honor.

The Court: The question in the Morrissey case was whether business was carried on by individuals whose taxable—it was an association taxable as a corporation.

Mr. Burnstein: That is right.

The Court: It is one of the leading cases, but it is not a case that involves the question of a permit, qualification to do any certain kind of business.

Mr. Burnstein: No; if I recall correctly—and I will stand corrected—— [38]

The Court: Of course, if your point is that the individual should be regarded as an association, taxable as a corporation, up until the time the corporation is actually functioning, then I would get your point.

Mr. Burnstein: That is exactly what I am.

The Court: Is that what your point is?

Mr. Burnstein: Yes; their position is so inconsistent, and I have pointed this out before in our letters. I can't follow their major premise upon which they have attacked this, as in the opening



statement that Mr. Boyle has given you this morning.

If they are going to go the way they said, in the corporation, they would be in line with the Morrissey case situation. Whether I am right or wrong. I would like to have the opportunity to brief that matter because I think that we have authority to support us.

I honestly believe this, your Honor. I don't think a permit was necessary, if the Court please, and I think I can convince your Honor that a permit was not necessary for the corporation to do what it was doing.

The Court: I don't think, Mr. Burnstein, that the respondent's position is based solely upon that matter of who had a permit to manufacture wine and distilled spirits. As I understand the respondent's contention, this is a cumulative matter.

There are a good many things that were not done, and [39] taking all of them into account, the Commissioner determines that the corporation didn't start to do business until a certain date.

Mr. Burnstein: I would like to, if the Court please, in line with what your Honor just said, offer into evidence just for the purpose of showing upon—showing the basis upon which the Commissioner has started this assessment, and this deficiency of the revenue agent's report.

The Court: I am not sure that you can introduce into evidence the revenue agent's report.

Mr. Burnstein: I have authority for it, I think, your Honor, based upon your Honor's statement. I

have authority for the fact that we may introduce into evidence the——

The Court: Do you have the revenue agent's report?

Mr. Burnstein: No, I haven't, but I would get it prepared and I will keep the record open to offer it, if I may.

The Court: How do you think you are going to get it, Mr. Burnstein?

Mr. Burnstein: Well, I would say this. I think Mr. Boyle and I could stipulate that the revenue agent's report that was attached to the thirty-day letter is the report that was filed with the Commissioner.

The Court: Well, I don't think you have ever tried to get one of those revenue agent's reports in evidence, and you better find out first all of the difficulties in doing that [40] because it is a hard thing to do.

Mr. Burnstein: May I ask this?

The Court: Because of rules of the Bureau of Internal Revenue about those reports.

Mr. Burnstein: Yes, your Honor.

The Court: They do not have to release them and you would have to find out whether the respondent will release that report, and we can't force them to release the report, either, you see.

Mr. Burnstein: Yes; I understand that, your Honor, but I was assuming, maybe presumptuously, that the report of the agent which was embodied in the 30-day letter notice, which is substantially prob-

ably what the report had, other than extraneous things that the Court couldn't take notice of anyway, since it is not evidence—could be arrived at by Mr. Boyle and myself, which would show the basis upon which the alleged deficiency has been made.

I only say that for this reason, your Honor—and I don't want to belabor this point. I only say it for this reason: that I respectfully believe that there are enough facts here for the corporation to be construed to be in existence as of the time this income was earned.

I do believe that an undue emphasis has been placed upon, even after your Honor has an opportunity to read the stipulation of facts, upon the lack of the license. The [41] license seems to be the thing that is the important matter in so far as the corporate entity is concerned.

The Court: Let me just call your attention to another principle in this field of taxation. I think you are going to run into it here.

Mr. Burnstein: Yes, your Honor.

The Court: Income sometimes derived from property, earned by property and in other instances income is the result of an individual's services, labor and so forth.

Mr. Azevedo, when he took over the winery from Christian Brothers in the first instance, went ahead into one season of production. That was what you have termed as the crushing season. His capital was used to purchase grapes; grapes were then crushed; the liquid was treated in various ways

and then the result of that operation was a marketable product.

Mr. Azevedo owned that product. He then sold it; the income produced by that property as a result of the sale of the property belongs to the person who owns the property. There is where you begin to analyze your problem in this case. Who owns the property that was sold? Who sold the property? He may have had agents selling for him; he may have had an agreement with people to pay them for their services, or to give them a share of the profits for some reason or other.

There is the starting point. Another taxable [42] entity comes into being. I don't think actually that this matter of who had a federal permit is necessarily the most critical point in this case. We have to always get back to the basic question of who owns the property that produces income, or who renders the services that produce income.

If there is some property in existence, and a new taxable entity is created, such as a corporate entity, there has to be a formal transfer of property, and it is a formal matter. It can't be handled loosely. Then what property are you going to be concerned with? There are two or three kinds of property here.

Mr. Azevedo can convey realty to a corporation, or he can convey realty to some individuals. He can have an inventory of wine on hand; that can be conveyed. If the parties handle these things in a loose way without paying any attention to tax consequences, that is just too bad, and although we



understand in this work that people in cities are more likely to have tax accountants and technicians at hand, and around them, people in small towns—Sacramento is not a small town; Sacramento is the capital of the state, and it has a thriving business. It is an important community; it is not like St. Helena in Napa Valley.

Mr. Azevedo isn't a businessman in St. Helena or in Napa, he is up in a good-sized city in this state where there are banks, lawyers, tax advisers, accountants and so forth. [43] Mr. Kershaw, who is here in the courtroom, looks as though he is a gentleman who has had some experience in business. So why things were handled loosely is something that you really have got to explain. It does make a great deal of difference tax-wise, whether the income is taxed to the corporation or whether it is taxed to the individuals, of course, but taxation is so very serious that things have to be handled carefully, and with some measure of exactitude.

So just remember that you have got to look at these points of who owns property, when does title pass, and who earns income.

The stipulation of facts is received and made part of the record.

Mr. Boyle: If your Honor please, I did not quite complete my statement. I was waiting——

The Court: All right; I will complete what I am doing. I thought you had completed. If you haven't completed what you are saying, then don't stop. You stopped.



Most of these exhibits are returns, or purported returns. I will receive some of these now.

3-C is received in evidence; that has been explained. No question about 4-D. That is the amended return of the winery for the period March 4, 1946, to March 3, 1947. That is received in evidence as Exhibit 4-D.

Why are you introducing in evidence the returns of [44] the petitioners, just because that is the usual thing to do? Is there any problem about it, 8, 9 and 10?

Mr. Boyle: That has to do with an alternative that I would like to present now. We have the real question before us, is there taxable income for this year, and I have an alternative approach.

The Court: Well, up to now you haven't said one thing about an alternative approach. I will take that up in a few minutes. I want to inquire about some of these agreements.

The last exhibit you have marked is 10-J, I believe, is that right?

Mr. Burnstein: That is right, your Honor. The last exhibit on the stipulated fact is 10-J.

Mr. Boyle: If your Honor please, we handed out originally——

The Court: I will come to that in a minute, Mr. Boyle.

Is the original return of Mills Winery for the period March 4, 1946, and March 3, 1947, to be received as a joint or as an individual exhibit?

Mr. Burnstein: We will accept it as a joint exhibit, your Honor.

The Court: That will be received as 11-K in evidence. The clerk may mark these exhibits. We will take a recess for a few minutes. [45]

(The documents above referred to were received in evidence and marked Joint Exhibits 3-C, 4-D, and 11-K.)

(Short recess taken.)

The Court: Mr. Boyle, have you something further in connection with your opening statement?

Mr. Boyle: Well, if your Honor please, would you care at this time to receive the alternative argument?

The Court: Yes; I want to know everything that is involved in this case, as part of your opening statement.

Mr. Boyle: The respondent presents this as an alternative: That if the Court should find that this income that is in issue here belonged to the corporation and was returnable by the corporation, that then the young men, Robert Azevedo and Paul Kershaw, Jr., in the year before the Court, 1946, nevertheless did receive a dividened of \$50,000 apiece inasmuch as the father was paid that amount; actually he paid \$110,000, but the adjusted agreement, or the adjusted price to him was \$100,000 as set forth in the agreement of December.

He did receive that money and it was paid out of this one fund, and if the Court finds that it was the corporation's fund, then the corporation paid an indebtedness of the young men which they never

paid back to the corporation, and therefore, they did receive dividends of \$50,000 apiece by the fact the corporation paid that indebtedness of theirs, and in that [46] respect, I will offer in evidence the corporate income tax return for the period March 1, 1951, to February 29, 1952.

The Court: Any objection to that exhibit?

Mr. Burnstein: Yes, your Honor.

The Court: State your objection.

Mr. Burnstein: Our objection to the offering of this exhibit on the basis for which it is offered is on the grounds that even construing the liberal method in which the Tax Court has the right to make a determination on the deficiency, that this is beyond the issues of the pleadings raised before this Court.

On that basis I think primarily that is my objection, your Honor.

The Court: This is not the proper time to offer exhibits during the conference. The Court indicated to you that the Court feels it would be necessary to take some testimony in this case. Therefore, we will go on to a trial of the case, and when we get into that, that will be the proper time for you to offer your exhibits.

The petitioner's counsel has raised the point about the pleadings, and the Court was going to raise the same question. Where in your pleadings do you raise the issue that an amount of income was realized constructively by these taxpayers in the alternative, in the amount of \$50,000 each? I don't see that in your answer. [47]

Mr. Boyle: They are not in the pleadings, your Honor.

The Court: Well, even though it is a rule of this Court that we will not consider questions not covered by the pleadings, and you run a risk, but you can argue—this case seems to be just 95% argument at the present time—you can argue in your briefs that the issue pleaded is broad enough to cover the question, but you run a risk in doing that because the Court might rule when it takes the case under submission that the pleadings are not broad enough to cover that question.

Mr. Boyle: Yes, your Honor.

The Court: At any rate, I think, if you are going to raise that question, I think you ought to amend your answer and raise it clearly in your pleadings.

Mr. Burnstein: Of course, your Honor, just for the sake of the record, we would——

The Court: Will you rise, please, when you address the Court?

Mr. Burnstein: For the sake of the record, in response to your Honor's statement of amending the pleadings, we would at this time object to any permission being granted at this very late and dilatory method of amending.

The Court: You think the amendment at this time would be untimely?

Mr. Burnstein: I think so, your Honor. [48]

The Court: We will wait and see whether Mr. Boyle is going to amend his answer. You can make your objection at that time.

Mr. Burnstein: Thank you, your Honor.

The Court: There are exhibits that were offered and which were attached to the stipulation of facts which the Court has not yet received in evidence. I will take that up this afternoon.

I understand that there are witnesses here who are available to respondent. Respondent has the burden of proof in this case, and those witnesses are asked to return this afternoon. We will recess until two o'clock.

Mr. Burnstein: Thank you, your Honor.

(Whereupon, at 12:15 o'clock, p.m., a recess was taken until 2:00 o'clock, p.m. of the same day.) [49]

(After Recess.)

The Court: Would you proceed, Mr. Boyle?

Mr. Boyle: Mr. Kershaw, would you please take the stand?

The Clerk: Please state your name and address for the record?

Whereupon,

PAUL KERSHAW, JR.

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Witness: Paul Kershaw, Jr.

The Clerk: And your address?

The Witness: Route 2, Box 2652, Sacramento, California.



(Testimony of Paul Kershaw, Jr.)

Direct Examination

By Mr. Boyle:

Q. Mr. Kershaw, are you one of the Petitioners in this case?      A. I am.

Q. Are you in business today?

A. I am an officer of a corporation.

Q. What is the name of the corporation?

A. Mills Winery.

Q. What is the nature of the activity performed by the [50] corporation?

A. Distilling and producing wines.

Q. Where is it located?      A. Sacramento.

Q. For how long have you been an officer of the corporation?

A. Approximately nine years.

Q. Can you give a beginning date for that activity?      A. March 4, beginning, 1946.

Q. Do you know John Azevedo?      A. Yes.

Q. Did you ever have business relations with John Azevedo with regard to the Mills Winery property and premises at Mills Station?

Mr. Burnstein: If the Court please, I would like to have some statement by counsel for the proper foundation as to when——

The Court: Will you please rise when you address the Court?

Mr. Burnstein: I am sorry.

The Court: If you have an objection to make, make it.

(Testimony of Paul Kershaw, Jr.)

Mr. Burnstein: I have an objection upon the ground——

The Court: The objection is overruled. Proceed, Mr. Boyle.

Q. (By Mr. Boyle): Did you ever have a business relation with John Azevedo in connection with the premises of the Mills Winery at Mills Station, California? A. I did.

Q. Did you have business relations with him in 1945? A. I did.

Q. Would you relate those business relations?

A. Well, about in July of 1945, John Azevedo had taken his winery to put into operation and to crush grapes and make wine, About August 1, the following month, why, we entered into an agreement that Robert Azevedo, his son, and myself, would purchase the winery from him, and that we would proceed, beginning then as partners, which we did so until March 4, 1946.

Q. Did you ever reduce your understanding to writing?

A. Not at that time. It was oral agreement, but I believe around in December when we were through crushing and there had been obligations made at the bank by John Azevedo and the crushing was over with, we had made all the wine, he felt that something should be put in writing of what we had originally agreed to.

Q. How many documents were reduced to writing, one or more?

(Testimony of Paul Kershaw, Jr.)

A. I believe so, yes.

Q. How many? [52] A. Two.

Q. I show you Exhibits 1 and 2, 1-A and 2-B, and ask you if those are copies of the written agreement between you and John Azevedo, you and Robert? A. Yes.

The Court: Mark this for identification, please, Exhibits 1-A and 2-B.

(The document above referred to was marked Joint Exhibits 1-A and 2-B for identification.)

Mr. Boyle: If I may ask the Court a question, shall I proceed as if this is not in evidence, nothing in evidence?

The Court: Those two exhibits have not been received in evidence.

Mr. Boyle: I have here 3-C and 4-D and 11-K have been received.

The Court: Those were received in evidence, yes, that is right.

Q. (By Mr. Boyle): Mr. Kershaw, would you state the nature of your duties and the work performed by you during the period beginning December 1, 1945, and ending March 1, 1946?

A. Well, at that time, the wine was completed and I was then—it was my duty then to see and watch the market and to line up sales for this wine.

Q. And did you do that? Were you engaged in this [53] activity full time? Was that the only busi-

(Testimony of Paul Kershaw, Jr.)

ness undertaking that you engaged in at that time?

A. From December to March, I believe so.

Q. And were you in partnership during that time with Mr. Robert Azevedo?

A. That is right.

Q. And will you state whether you know whether that was his fulltime occupation during that period?

A. It was.

Q. Will you state the nature of your duties and work performed between March 1, 1946, and August 6, 1945?

A. I handled the sales of wine.

Q. In the same manner that you had prior to that time?

A. That is right.

Q. And could you state as to the activities or work performed by Mr. Robert Azevedo during that period of March to August, 1946?

A. Robert Azevedo was our winemaker.

Q. Was he engaged fulltime during that period?

A. Yes.

Q. What did you receive for your services during the first period from December, 1945, to March 1, 1946?

A. I didn't receive anything for my services.

Q. What was your understanding as to your salary or compensation? [54]

A. Between that period we were partners, and there was no salary.

Q. What did you anticipate might be the source of profit to you and your partner?

A. We had no idea between—we were just com-

(Testimony of Paul Kershaw, Jr.)

pleting our wine and the market showed no indication of what the price would be. In fact, it started to develop in late February. There was no way of knowing how much profit—in fact, there is never any way in the wine business of knowing.

Q. What did you anticipate might be the source of your profits at any time during the year 1946?

A. There was no way of knowing.

The Court: What was the source, the sale of wine?

The Witness: Oh, yes; through the sale of wine.

Q. (By Mr. Boyle): Exhibit 1-A states that you and Robert were to pay John Azevedo \$100,000?

The Court: It doesn't, Mr. Boyle. Exhibit 1-A does not refer to any amount of money. I am sorry to contradict you. You may look at the exhibit again, if you wish.

Q. (By Mr. Boyle): Mr. Kershaw, I show you Exhibit 1-A and direct your attention to Paragraph 3—I beg pardon, Paragraph 1 and ask you to please read that.

“It is mutually understood and agreed by and between [55] the parties that seller will sell to purchasers a certain winery known as Mills Winery, located at Mills Junction, California, together with all the assets pertaining thereto for the adjusted cost of said winery, plus all other of said winery, including inventory at cost price.”

What is your understanding as to the amount of the adjusted cost you were to pay John Azevedo?



(Testimony of Paul Kershaw, Jr.)

A. Well, I understood we were to pay him \$100,000.

The Court: How did you have that understanding? Who arrived at that figure?

The Witness: That was John Azevedo's figure.

Q. (By Mr. Boyle): Did you and Robert Azevedo pay John Azevedo \$100,000?

A. I believe it was \$110,000.

The Court: Will you wait a minute? Mr. Burnstein, will you come up to the bench, please?

Mr. Burnstein: Yes, your Honor.

The Court: Read that last question?

(Question read.)

The Court: Mr. Kershaw, now whether or not it was \$100,000 or \$110,000, the question is did you pay an amount of money to John Azevedo, you and Robert?

A. We did.

Q. When did you make that payment? [56]

A. It was different payments that we withdrew from the corporate funds.

Q. Did you make it by check?

A. There was a check drawn from the bank account for that.

Q. In what year did you make payments? Were they made at various times?

A. Various times in 1946.

Q. All the payments were made in 1946?

A. Yes.

Q. Where did you get the money to make the

(Testimony of Paul Kershaw, Jr.)

payments?           A. From the corporation.

Q. Where did the corporation get the money?

A. From the sale of wine.

Q. How did the corporation get the wine?

A. From the partnership.

Q. How did the partnership get the wine?

A. They produced the wine.

Q. Did the partnership have any money?

A. The money was borrowed from the Capital National Bank at Sacramento.

Q. By whom was it borrowed?

A. Mr. John Azevedo made the arrangements for the loan.

Q. Was it loaned to John Azevedo?

A. It was. [57]

Q. Wasn't it his money?

A. Well, with our agreement that we were partners, we understood that it would be ours.

Q. Did you and Robert ever sign a note to the bank?           A. No.

Q. Did you put any capital into this alleged partnership?           A. No.

Q. Did Robert put any capital into the alleged partnership?           A. No.

Q. Who put capital into it?

A. There was no capital. It was all borrowed from the bank.

Q. Well, you can get capital by borrowing capital. Is John Azevedo supposed to be a member of this partnership?           A. No.

Q. Mr. Kershaw, assuming, without deciding—

(Testimony of Paul Kershaw, Jr.)

I won't make any decision on the point, but assuming without deciding that you and Robert formed a partnership orally?      A. Yes.

Q. It would be a partnership in which neither of you contributed any capital?

A. That is right.

Q. What was the business of the partnership supposed to be? [58]

A. The partnership was producing wine.

Q. It was going to enter into the business of making wine?      A. Yes.

Q. From the introductory statement of counsel the Court understands that in order to make wine you would have to buy grapes or other fruit and crush it, and so forth?      A. Yes.

Q. You have to have money to carry on the business?

A. Well, that money was borrowed from the Capital National Bank. The Capital National Bank was willing to finance the complete crush, 100% through the loan.

Q. But the loan was made to John Azevedo?

A. That is right.

Q. Did he in turn loan the money to you and Robert?      A. It was for the partnership, yes.

Q. Was the bank repaid?      A. It was.

Q. Out of what?

A. The bank was repaid from the sale of the wine during the period of the corporation, who assumed the liabilities of the partnership, and liabilities on the wine.

(Testimony of Paul Kershaw, Jr.)

Q. How much money was borrowed from the bank?

A. I believe, your Honor, it was around \$440,000.

Q. When was that money borrowed? [59]

A. In the fall of 1945.

Q. Was the partnership in existence in the fall of 1945? A. That is right.

Q. When was this alleged partnership formed?

A. August 1, 1945.

Q. Then the partnership purports to purchase the winery from John Azevedo; is that right?

A. In December.

Q. That is the idea, that the partnership purchase the property? A. That is right.

Q. For \$110,000? A. Yes.

Q. That makes a total indebtedness of this alleged partnership of \$550,000. That is a lot of money. Where are your books?

A. Where are our books?

Q. Did the partnership keep books?

A. The partnership kept books, yes, but when I state books, the partnership kept a check ledger showing all the expenses paid out and the loans that were made, and the amount of money owing to the bank.

The Court: Mr. Boyle, when you resume your direct examination of Mr. Kershaw, would you please make a note that there is a purported indebtedness of the partnership allegedly [60] formed on August 1, 1945, in the amount of \$550,000?

In answer to your question that \$110,000 was paid

(Testimony of Paul Kershaw, Jr.)

to John Azevedo by this alleged partnership, the witness stated that the payment was made out of the proceeds from the sale of the inventory of wines. I do think that you ought to lay some foundation here.

I understand that there are no books of records here, but there is a necessity for us to find out what the net proceeds from the sale of the inventory amounted to. Did they get \$550,000? Did they have that large an inventory?

You indicated this morning that you thought you would like to offer into evidence the corporation income tax return. The corporate returns would be for a later period than this. We did receive something in evidence, the original amended corporate return for the period March 4, 1946, to March 3, 1947.

There was received as a Joint Exhibit, 3-C, a copy of what purports to be a retained copy of a partnership return of Mills Winery for the period August 1, 1945, to March 1, 1946. At I understand it, there is no record in the collector's office of a partnership return ever having been filed. This return names Paul Kershaw and Robert Azevedo as the partners, and shows inventory beginning the year, none; inventory at the end of the year, gross profit, \$32,875.86.

I must say that I still can't see how this operation [61] was carried on, because the profit of 32,000, that is gross profit and not net, ordinary net



(Testimony of Paul Kershaw, Jr.)

income reported for the year of operation of the partnership. When did this partnership end, Mr. Kershaw?

The Witness: March 1, 1946.

The Court: That is your contention?

A. Yes.

The Court: The government contends that it did not end until August 1, 1946, about then. A taxable period which seems to be the one and only taxable period of the purported partnership is indicated. The partnership doesn't make enough money to pay off this indebtedness of \$450,000, or rather, \$550,000. That is exactly the point that disturbed me since we started this morning, and it is the reason why I have been reluctant to have you submit this case on a bare stipulation of facts.

Is there anything in your stipulation that indicates the source of the payment of any money to John Azevedo?

Mr. Boyle: I believe there is in part, your Honor. I can clear up that point, I believe.

The Court: I would like to have you clear it up.

Q. (By Mr Boyle): Mr. Kershaw, at the time you had your oral understanding with Mr. John Azevedo in August, 1945, had Mr. John Azevedo borrowed [62] some money from the Capital National Bank of Sacramento?

A. He had made arrangements to borrow money. I do not believe on August 1st there was money borrowed.

(Testimony of Paul Kershaw, Jr.)

Q. Whatever the arrangements were when they came to fruition, how much was borrowed?

A. About \$440,000.

Q. At the time you entered into your written contract in December, do you recall whether the contract stated that you were acquiring it strictly for \$440,000 indebtedness that John owed the bank?

A. I don't——

The Court: What agreement are you referring to, 1-A or 2-B?

Mr. Boyle: 1-A, your Honor.

The Court: What is your understanding of what 1-A is? It is not a partnership agreement, is it?

Mr. Boyle: No, your Honor. I understand that this constitutes the agreement between the parties; that is, John the seller and the two men buying, that they were to buy——

The Court: Read the last question?

(Question read.)

The Court: Will you reframe your question to make it clearer? [63]

Q. (By Mr. Boyle): What did you purport to buy at the time you entered into the arrangement or the contract with John Azevedo?

A. The winery.

By the Court:

Q. What do you mean by that?

A. The physical property of the winery itself: the buildings and land.

Q. Realty?           A. Yes.

(Testimony of Paul Kershaw, Jr.)

Q. Buildings? A. That is right.

Q. How many buildings were there?

A. Oh, around five buildings, your Honor.

Q. (By Mr. Boyle): At the adjusted basis of \$100,000; is that right? A. That is right.

O. And you also purported to buy an inventory of wine constituting the '45 crush; is that right?

A. No; we entered into an oral agreement before there was any wine made.

Q. But in reducing it to writing, did you purport to buy the inventory then on hand?

A. I don't believe that was in the contract.

Q. What happened to the inventory?

A. Well, the inventory at the beginning of August 1, [64] which we agreed to accumulate this inventory under a partnership. The reason for the contract to speak of December 1st was because John felt that the crush was over with, that we had accumulated this inventory, that he had signed notes at the bank and he felt he should have something in writing besides an oral agreement.

Q. It says under Paragraph 1: "Adjusted cost of said winery plus all other of said winery, including inventory, at cost price."

Did you buy the inventory at cost price?

A. It is hard for me to say that we bought the inventory when it was already agreed that inventory was ours.

Q. What did you pay for the inventory?

A. The money that we borrowed from the bank would be the cost price of the inventory.

(Testimony of Paul Kershaw, Jr.)

Q. Then your position is that you borrowed the money from the bank, the \$440,000 to acquire the '45 crush; is that right?

A. John Azevedo borrowed it for us, for the partnership.

The Court: Was that because you didn't have any line of credit with the bank?

The Witness: That is right.

Q. (By Mr. Boyle): Then, in other words, you acquired the inventory by taking over that indebtedness of \$440,000, which was to be paid [65] back to the Capital National Bank of Sacramento; is that correct?

A. Well, when you state that we acquired it, to me it seems that you are asking did we buy this inventory after it was made for \$440,000. Well, that was not the case. We had no inventory to start with. This was an inventory that accumulated in our partnership, oral agreement.

Q. When did you first start buying grapes from the farmers?

A. In the month of August. We had an early season that year; it was early in August.

The Court: If I may interrupt you here.

By the Court:

Q. If I understand you now, you and Robert had no line of credit with the bank?

A. That is right.

Q. The father John did have?

A. That is right.

(Testimony of Paul Kershaw, Jr.)

Q. He borrowed \$440,000 from the bank, gave his note, is that right?

A. That is correct.

Q. Turned it over to you and Robert?

A. That is right.

Q. And then who actually went out and bought the grapes? A. I did, your Honor. [66]

Q. What did John Azevedo do?

A. Mr. John Azevedo was a contractor prior to owning the winery and there was remodeling to be done on the plant, and he stayed there for the purpose of helping us receive the money in the bank and supervising certain construction work at the winery. The son was the winemaker and I was out purchasing grapes for the winery.

Q. And John Azevedo was not in the wine-making business at all, is that a fact?

A. He was there present, but——

Q. What was his regular business in 1944?

A. He was a contractor.

Q. What did he do, build houses?

A. Yes; he built large buildings. In fact, in Sacramento he built the fair ground stands; I believe the motor vehicle department, a very large building.

Q. Does his building and construction business have a name, or does he do it under a certain name?

A. I believe under the name of Azevedo.

Q. It has been stipulated, or the Court has been told that Mr. Azevedo rented the Mills Winery to the Christian Brothers Winery; is that right?



(Testimony of Paul Kershaw, Jr.)

A. That is right.

Q. When did he take back that property?

A. In 1945. I don't know the exact date of the relationship [67] between the person who was leasing the plant, but I think it was the end of June that he took back the plant.

Q. This may be getting into his end—I am afraid a little of it is, but we will have to proceed in this way because John Azevedo isn't here. He is not here, is he?           A. No.

Q. Did he say to you that he was going to operate the Mills Winery?

A. Yes; he had intentions of operating it when he took the plant back.

Q. Did he ever operate it?

A. Well, your Honor, in July his intentions were to operate the plant, and I was called in at that time to take care of sales.

Q. Where had you been working?

A. I was in Oakland, up here in Oakland and in August John Azevedo decided he would step out of the picture before we started to produce anything at all, and that he would sell half the winery to his son and the other half to us if we wanted to take it over for a certain sum of money.

Q. "Us," meaning you and your wife?

A. No; myself and Robert Azevedo, the son.

Q. Well, you said he would sell one-half to Robert and one-half to "us." You mean to yourself?

A. I meant to myself. [68]

Q. And did he do that?           A. Yes.

(Testimony of Paul Kershaw, Jr.)

Q. Then at what point was the money borrowed from the bank; was that before or after the oral agreement was made between you and Robert?

A. After, your Honor.

Q. What were the circumstances under which this oral agreement was made between you and Robert? A. That we would be partners.

Q. How did you come to enter into that agreement? A. Well, the agreement was——

Q. Is Robert Azevedo here? A. No.

Mr. Burnstein: No, your Honor.

The Witness: The father was—John Azevedo was the one who had the sole idea of selling out and offering this to us, which we accepted.

By the Court:

Q. What were the terms of this oral partnership agreement?

A. That we would be partners and that we would split our profits, and that we would——

Q. On what basis would you split your profits?

A. The profits from the business itself.

Q. On what basis? [69] A. Fifty-fifty.

Q. Go ahead. A. What question?

Q. What were the other terms of this oral agreement under which you were to carry on the business in partnership? It takes a lot more to carry on the business in a partnership than you have already set forth. Tell us the whole story.

A. To acquire the winery we would be obligated to pay John Azevedo a certain sum of money.

Q. Listen, this is a tax case, and we are awfully

(Testimony of Paul Kershaw, Jr.)

interested in figures. Don't tell us "a certain sum of money." A. \$110,000.

Q. Go ahead.

A. And we went out and proceeded to make wine. I was buying grapes; Robert Azevedo was the wine-maker. The father was able to go to the bank and make loans for us and we both sold our crush. Our crush ended around December, as I stated before, and Mr. John Azevedo said that now that the crush was finished and the wine was made and that he had signed these notes he felt he should have something in writing from us in regards to our partnership and what we owed him.

Q. So then what did you do?

A. From that period on there was a certain amount of work to be done to wine to finish it and prepare it for market. In the month of January and February I was seeking markets [70] whereby we could dispose of this wine.

Then as partners we got together and agreed that we would form a corporation of the Mills Winery, and that was done on March 4. At that time we agreed as partners that the whole inventory and the assets and liabilities would go into the corporation. We filed our closing income tax, set up books for the corporation beginning March 4.

Q. Where are the books?

A. The books——

Q. Up at the winery?

A. Partly; the bookkeeper in Los Gatos.

(Testimony of Paul Kershaw, Jr.)

Q. Do you have an office somewhere else?

A. Our bookkeeper has an office in Los Gatos. Our office is at the winery.

The Court: Go ahead, Mr. Boyle. I am sorry; I didn't think my questions would take this long.

May I call your attention to the fact that Exhibit 2-B is unexecuted? It refers to John Azevedo doing business as Mills Winery. It doesn't refer to any partnership.

Q. (By Mr. Boyle): Mr. Kershaw, from what source was the Capital National Bank of Sacramento paid back the \$440,000?

A. From the sale of wine.

Q. Of the 1945 crush?

A. Yes; which was sold between March and June of 1946. [71]

Q. And is it from the sale of the 1945 crush that we derive the income in issue here?

A. Yes.

Mr. Burnstein: What were you referring to, counsel, when you said "here"?

Mr. Boyle: This tax matter here.

Q. (By Mr. Boyle): I show you Paragraph 7 in the stipulation of facts and direct your attention to the bottom thereof, the bottom of the page, which says, "The agreed price of \$100,000 was paid as follows."

Do you see that? A. Yes.

Q. Is that the way the \$100,000—well, correction, \$110,000. Let me ask you, first of all, why did

(Testimony of Paul Kershaw, Jr.)

you pay John 110,000, when the adjusted basis was 100,000?

A. Well, he felt, with the amount of construction that the corporation was doing, had planned to do, we asked him to stay there and he felt he should receive 10,000 more than we originally agreed to, and it amounted to 110,000.

Q. He stayed on the premises?

A. That is right.

Q. This last payment was made July 4. Was he still on the premises then? A. Yes. [72]

Q. It is stipulated that the source of these payments was out of the profits from the 1945 crush; is that your understanding? A. Yes.

Mr. Boyle: Will you mark that for identification?

The Clerk: Exhibit E for Identification.

(The document above referred to was marked Respondent's Exhibit E for Identification.)

Q. (By Mr. Boyle): I show you Exhibit E for Identification, which purports to be the minutes of the first meeting of the board of directors of Mills Winery on March 20, 1946, and ask, is that your signature at the bottom thereof?

A. That is right.

Q. Is this a true and correct document or recordation of the minutes of that meeting? A. Yes.

Mr. Boyle: I offer this in evidence, your Honor.

The Court: Any objection?

Mr. Burnstein: No, your Honor.



(Testimony of Paul Kershaw, Jr.)

The Court: E is received in evidence.

(The document above referred to was received in evidence as Respondent's Exhibit E.)

The Court: What are you offering this for?

Mr. Boyle: Merely as background, your Honor, and also [73] as a part of Petitioner's case to show they did have officers as of that date.

The Court: Part of respondent's case?

Mr. Boyle: Well, we are trying to give the facts that existed. I have another one to be marked.

The Court: Exhibit G for Identification.

(The document above referred to was marked Respondent's Exhibit G for Identification.)

Q. (By Mr. Boyle): I show you Exhibit G for Identification, which purports to be the minutes of a special meeting of the Board of Directors of Mills Winery on the 12th day of August, 1946, and ask is that your signature at the bottom of the last page?

A. That is right.

Q. Is this a true and correct copy of those minutes?

A. Yes.

Q. Directing your attention to page 3—

Mr. Burnstein: Well, if the Court please, I am going to object to any reference to the minutes until your Honor rules upon the admissibility of these for the purpose for which counsel intends to use them, which was just at the very end of the morning session.

This is one of those steps in that alternative plan of his that I would like to have an opportunity to

(Testimony of Paul Kershaw, Jr.)

discuss with your Honor. [74]

Mr. Boyle: I will offer this in evidence at this time.

Mr. Burnstein: Your Honor, if I may, I would like to find out for what purpose it is offered because if it is offered for the purpose of attempting to lay some foundation for an alternative procedure that Mr. Boyle discussed with your Honor before the noon recess, I respectfully believe that it is not admissible for that purpose.

The Court: He didn't discuss anything with me before the noon recess. He presented to the Court an alternative intention; there is a great difference between discussing anything with the Court and saying that you make an alternative contention.

This is F for identification?

Mr. Boyle: G for identification.

The Court: You have heard the objection of petitioner's counsel. What do you have to say about that?

Mr. Boyle: G for Identification is a recordation of the minutes of a meeting. It is actually in this case for several reasons. It has other meaning besides the alternative contention that respondent intends to make at the end of the trial.

The Court: Objection is overruled. Go ahead, Mr. Boyle.

Q. (By Mr. Boyle): Directing your attention to page 3, specifically to [75] the first paragraph at the top, would you please read the first sentence?

A. "Now, therefore, be it resolved that upon the

(Testimony of Paul Kershaw, Jr.)

issuance of a permit by the corporation commissioner, the department of investment for the issuance of such shares that Robert J. Azevedo and Paul Kershaw, Jr., shall pay to this corporation for the obtaining of a deed for the real property upon which the business is to be operated by this corporation is located, the sum of \$55,000 each, or a total of \$110,000 in cash."

Q. That is enough. Did you pay to the corporation \$110,000 in cash after August 12, 1946?

A. I have not.

The Court: I didn't hear you?

The Witness: I did not.

Mr. Boyle: I offer Exhibit G for Identification in evidence, if it was not received previously.

The Court: It was received previously. You offered it before. However, we will be clear about it. G is received in evidence.

(The document above referred to, marked Respondent's Exhibit G, was received in evidence.)

Mr. Boyle: I offer in evidence at this time photostatic copies of the individual income tax return of Robert Azevedo for the year 1946. [76]

The Court: Without objection that is received in evidence as Exhibit H.

Mr. Boyle: I offer in evidence the 1946 individual income tax return of Paul Kershaw, Jr.

Mr. Burnstein: No objection, your Honor.

The Court: Received as Exhibit I. in evidence.

(Testimony of Paul Kershaw, Jr.)

Mr. Boyle: I offer photostatic copy of the 1946 individual income tax return of Irene Kershaw.

The Court: Received as Exhibit J in evidence.

(The documents above referred to were received in evidence and marked Respondent's Exhibits J, H and I.)

Mr. Boyle: May I have this marked for identification, your Honor?

The Court: Are you going to offer this or ask some questions about it?

Mr. Boyle: I am going to ask some questions.

The Court: Do you have an Exhibit K?

Mr. Burnstein: There is a K in evidence, your Honor.

The Court: K is the other return. This will be L for identification.

(The document above referred to was marked Respondent's Exhibit L for Identification.)

Q. (By Mr. Boyle): Mr. Kershaw, I show you L for identification which purports to be the corporation return from 1120 of Mills [77] Winery for the fiscal year ending February 29, 1952; is that your signature on this return? A. Yes.

Q. Is this a correct return of the corporation for that fiscal year? A. That was amended.

The Court: Will you speak up, please, Mr. Kershaw? I have to hear you.

The Witness: I think this income tax report was amended.

(Testimony of Paul Kershaw, Jr.)

The Court: Well, it was a return of the corporation, is that right, and you identify it as such?

The Witness: It is.

Q. (By Mr. Boyle): Directing your attention to the balance sheet on the reverse of this return, on the back sheet, page four, and specifically to notes and accounts receivable, I ask you to give the amount shown opposite that account at the beginning of the taxable year.

Mr. Burnstein: If the Court please, I am going to object to any testimony in connection with what appears on the corporation tax return of 1952 for the ground that it is incompetent, irrelevant and immaterial, and also beyond the issues framed in these pleadings that are now before this Court. [78]

The Court: What do you believe the issues are to which this question might relate?

Mr. Burnstein: The issue might relate to the alternative contention that counsel discussed, or argued, or brought before this Court before the noon recess. That would be the only purpose of it, if the Court please.

The Court: The respondent's pleading was not well drawn. The petitioner's pleadings were not well drawn, and so counsel for each party has proceeded under a certain kind of misunderstanding about how far their pleadings should go.

There is a misunderstanding, in my opinion, and it is not an oversight. At the end of the taking of testimony I will allow counsel for the petitioner



(Testimony of Paul Kershaw, Jr.)

and counsel for the respondent to amend pleadings, so as to make the pleadings proper.

Therefore, with that understanding, I will let Mr. Boyle proceed with his point, and your objection I will overrule.

Go ahead, Mr. Boyle.

Q. (By Mr. Boyle): Mr. Kershaw, will you read the figure opposite the item, "Notes and accounts receivable," at the beginning of the taxable year March 1, 1951, and ending February 29, 1952?

A. "\$13,171.35."

Q. Will you read the figure opposite that same item, [79] "Notes and accounts receivable at the end of the taxable year"?

A. "110,171.35."

Q. Do you recall the transaction underlying the increase in the accounts receivable?

A. I don't know why. I would have to have other records.

Q. Directing your attention also to Schedule L, the balance sheet, and specifically to line 14 thereof, entitled "Capital Stock," I ask you to state the figure, if any, opposite that item at the beginning of the taxable year.

A. There is no figure.

Q. What is the figure opposite that item at the end of the taxable year?

A. \$110,000.

Q. Do you recall why \$110,000 was inserted opposite capital stock at the end of the taxable year?

A. Well, it is possible that the figure of \$110,000 could be what Robert Azevedo and Paul Kershaw, myself, owed the corporation that they borrowed from the corporation.

(Testimony of Paul Kershaw, Jr.)

The Court: Well, you know what capital stock means. Do you know what that entry calls for on this return? Do you know anything about accounting?

The Witness: No, I don't, your Honor.

By the Court:

Q. Capital stock on the balance sheet means the stock of the corporation which is issued and outstanding, do you see? [80] A. Yes.

Q. And stock can't be issued under the laws of the State of California, I believe, unless something is paid in for the stock, either property or money.

The question is, the question Mr. Boyle asked you, is why the balance sheet of the corporation shows no stock issued and outstanding at the beginning of the year, but does show stock issued and outstanding at the end of the year. There is no answer to that question.

Did you make up this return?

A. No, I didn't.

Q. It is signed by C. W. Smith, National Accounting Service. Where is the National Accounting Service located?

A. The office is in Los Gatos.

Q. Do they have a San Francisco office?

A. No.

Q. Was stock of the Mills Winery corporation ever issued to you? A. Yes.

Q. Do you have stock certificates? A. Yes.

Q. How many shares of stock do you have?

A. At the present time, your Honor?

(Testimony of Paul Kershaw, Jr.)

Q. No; perhaps more has been issued now. The first amount of stock that was issued to you, tell me how many [81] shares you got and when it was issued to you?

A. 1,000 shares at \$100 a share, which is held in escrow.

Q. It was held in escrow?                      A. It still is.

Q. And who is the escrow agent?

A. I believe in the office of Mr. Popper and Mr. Burnstein.

Q. In the attorney's office?

A. That is right.

Q. A thousand shares at a par value of \$100 a share is \$100,000, so that no certificates were issued even though the stock was held in escrow. Were any certificates issued in your name and in Robert's name?                      A. Yes; both names.

Q. Were they issued in your names?

A. The stock held in escrow was issued in our names.

Q. Is there an escrow agreement? There usually is an escrow agreement if you put anything in escrow?                      A. I think so.

Q. Do you know anything about that?

A. I am not too familiar with it.

Q. Why is the stock being held in escrow?

A. Because I don't think the State of California, the actual value of the winery would have to be proven before they would release the amount of stock that was issued. [82]

(Testimony of Paul Kershaw, Jr.)

Q. You haven't cleared with the California Corporation Commission?

A. On the amount of the value of the stock.

Q. You didn't in 1952, and you haven't up to the present time?      A. That is correct.

Mr. Burnstein: Your Honor, may I—

The Court: You might have to take the stand after awhile.

Mr. Burnstein: I can explain that, your Honor.

The Court: We are now at the point of trying to take testimony and get evidence in this case, and I don't want any more of these explanations from counsel. They have no evidenciary value. Have you some further questions, Mr. Boyle?

Mr. Boyle: I offer L for identification in evidence, your Honor, and request permission to withdraw that and submit a photostatic copy.

The Court: Any objection?

Mr. Burnstein: No objection, your Honor.

The Court: L is received in evidence, with leave to substitute a photostatic copy. We will let you take that afterwards.

(The document above referred to was received in evidence as Respondent's Exhibit L.)

Mr. Boyle: That is all I have, your Honor, unless [83] you have some desire that I pursue a certain course of questioning. That is all the questioning I have of this witness, otherwise.

The Court: They are contending that the corporation began doing business on March 4, 1946;

(Testimony of Paul Kershaw, Jr.)

respondent contends that the corporation didn't start doing business until August of 1946?

Mr. Boyle: That is right, your Honor.

The Court: What you need to do is to ask questions about that time area. You ought to have a few more questions about that. What was the evidence of the corporation starting business on March 4, 1946?

Mr. Burnstein: Your Honor, may I ask a question? We have some stipulated facts and I am just wondering whether your Honor has accepted that stipulation or whether or not we are disregarding it?

The reason I mention that, this question you proposed to Mr. Boyle, all of the things that we purport that would assist the corporate entity are in there, and I did not want to take unfair advantage of Mr. Boyle at this moment to asking these kinds of questions.

The Court: We have received this stipulation of facts in evidence, and we won't have any problem unless something comes up that is in conflict with this stipulation of facts. The Court has not rejected it. It stands as your [84] stipulation. This is all supplementary; there may be some corroboration involved in questioning this witness. There may be some disputation, but the witness is here to clarify anything that can be clarified.

Mr. Boyle: Well, it was to avoid any possible conflict between his testimony and the stipulated facts that I hesitate. However, if there is any mat-



(Testimony of Paul Kershaw, Jr.)

ter on which he can testify which will clarify or explain any of these acts, I wish to do that.

The Court: If anything came out in the testimony that was in conflict with your stipulation of facts, why, that would be a problem you could handle later. You might have made some error in your stipulation and you might have to amend it.

Mr. Burnstein?

Mr. Burnstein: Yes, your Honor.

The Court: Direct my attention, please, to some argument in the stipulation—some paragraph in the stipulation that you think covers the matter about which——

Mr. Burnstein: Yes, your Honor, Paragraph 10.

The Court: One piece of evidence that the corporation went into business is that on April 9, 1946, Mills Winery as a corporation executed an agreement with third parties?

Mr. Burnstein: Yes, your Honor; the further paragraph also in that same paragraph numbered ten. [85]

The Court: "Corporation entered into written agreements with Southern Pacific Railway Company."

By the way, Mr. Burnstein, don't you have another exhibit that is related to the agreement with the Southern Pacific Railroad Company?

Mr. Burnstein: I have those here now, your Honor, and I would like to offer both of those into evidence; those are the agreements of May 11 and

(Testimony of Paul Kershaw, Jr.)

May 23, of 1946, which are referred to in that paragraph, your Honor.

The Court: You have no objection, Mr. Boyle?

Mr. Boyle: No, your Honor.

The Court: I believe the next exhibit of the petitioner will be 11. Have you made a record of that?

Mr. Burnstein: 11-K was in evidence.

The Court: The agreement between the corporation and the Southern Pacific dated May 11, 1946, is received in evidence as Exhibit 12.

Mr. Boyle: If your Honor please, we have a 12.

The Court: Then that will be Exhibit 13. The agreement with the Southern Pacific dated May 23, 1946, is received in evidence as Exhibit 14.

Mr. Burnstein: Your Honor, may I also introduce into evidence at this time the agreement that is likewise referred to in Paragraph 10, this fruit pulping and fruit distilling agreement entered into between the corporation and I—— [86]

The Court: No objection? That was one of the stipulated exhibits.

Mr. Boyle: No objection.

The Court: This is a joint exhibit received in evidence as Exhibit 6-F.

(The documents above referred to were received in evidence and marked 13, 14 and 6-F.)

The Court: What else in your stipulation of facts relates to actions by the corporation?

Mr. Burnstein: Paragraph 13. I believe in a substantial portion thereof.

(Testimony of Paul Kershaw, Jr.)

The Court: What other paragraphs?

Mr. Burnstein: Paragraph 12, your Honor. I am sorry; I skipped over 12.

The Court: What else?

Mr. Burnstein: Paragraph 17.

The Court: Yes.

Mr. Burnstein: Paragraph 23.

The Court: I will read the first sentence to you of Paragraph 23; "All sales of wine made during the period March 1, 1946, to August 6, 1946, were picked up as corporation gross income."

Tell me what you mean by "picked up." Picked up on the books?

Mr. Burnstein: Picked up on the books, were reported [87] as corporate gross income.

The Court: And were reported in returns?

Mr. Burnstein: Yes, your Honor.

The Court: You will agree to that, Mr. Boyle? It is a stipulation—the expression "picked up" is ambiguous.

Mr. Boyle: We agree that it was picked up when the returns were filed. We have no knowledge as to the date; actually, as a daily transaction that was recorded.

The Court: Your agent has seen the books of the corporation, I suppose?

Mr. Boyle: He has.

The Court: Did he find that there were entries, that there were accounts opened on the books as of March 4?

Mr. Boyle: Well, we are into an area of con-

(Testimony of Paul Kershaw, Jr.)

fusion again, your Honor. I do not wish to be in the position of trying to make evidence, but my statements may do so. Our understanding was that the same books were maintained by the father, by the partnership and by the corporation.

I would be happy if the witness is able to recall exactly whether that was true or not, or whether there were different books and records.

Mr. Burnstein: Well, your Honor, may I say this? It was somewhat news to me that Mr. Boyle would make such a statement after we discussed this on many occasions, and in the light of his admission in the answer. We have alleged in [88] our petition in Paragraph 5-P, if I recall, that books were open for the corporation on March 4.

That was admitted in the answer, and then I discussed it with Mr. Boyle, and I said if this is not a fact I don't want to take advantage of an improper admission, and we finally determined just the other day that the revenue agent did see these books open as of March 4. I don't want to make evidence either.

The Court: We have run into that problem before that one set of books is kept and they are supposed to be the books for two or more entities.

Mr. Burnstein: That is not the case here.

Mr. Boyle: Mr. Burnstein stated in correctly. I did not wish to stipulate that books and records were opened up and therefore we didn't stipulate specifically in that regard. It was only because your

(Testimony of Paul Kershaw, Jr.)

Honor focused our attention on that point that we have made these statements. Actually we aren't in a position to state the minute details of the book-keeping system on or about March 4.

The Court: You have your pleadings there. Will you please, for the record, tell me what subparagraph of Paragraph 5 your petition deals with?

Mr. Burnstein: 5-P, "on or about March 4, 1946, the corporate books and accounts were opened," and so forth.

The Court: To use an expression like "picked up" in [89] a pleading or in a stipulation is very poor. It is a colloquial expression and is likely to be ambiguous. The respondent admits that all sales of wine made during that period were "picked up." Whether he picked you up on the use of that expression and said, "Well, I will agree when they were picked up," it could have been something that was done at a later date, as of March 4, 1946, but I will deal with that later. That appears to be an admission by the respondent.

Mr. Burnstein: I do not believe, your Honor, that there are any other exhibits that we wish to offer into evidence at this time.

The Court: We will go back to Mr. Boyle. Are there any other questions of this witness?

Mr. Boyle: No, your Honor.

The Court: You may inquire, Mr. Burnstein.



(Testimony of Paul Kershaw, Jr.)

**Cross-Examination**

By Mr. Burnstein:

Q. Mr. Kershaw, after March 4 of 1946, what were your duties and activities in connection with the corporate activities? Did you do anything in regard to working for the corporation?

A. Yes; I was taking care of the sales.

Q. And as a person taking care of the sales, was it your duty to contact other fruit processors or brokers or other persons in the food processing industry? [90]

A. Yes.

Q. And as you did contact these people, did you make any representation or statement for whom you were dealing?

A. Yes.

Q. What did you say, if anything?

A. Well, I told people who I contacted, like brokers, that we had a corporation of Mills Winery, certain wines to offer on the market.

Q. Were these the same people that you might have contacted or did contact when you were a partner with Robert J. Azevedo?

A. There were a couple parties, yes.

Q. And these parties that were the same parties——

The Court: Don't lead your witness. You are asking leading questions.

Mr. Burnstein: Yes, your Honor.

Q. (By Mr. Burnstein): And did you contact

(Testimony of Paul Kershaw, Jr.)

these same parties after the corporation was organized?      A. Yes.

Q. And when you contacted those parties after the corporation was organized, did you say anything to them in regard to the formation of a corporation?      A. Yes.

Q. And what, if anything, did you tell [91] them?

A. I told them I was an officer, vice president of the corporation, and had charge of the sales.

Q. And did you eventually sell this wine that was the inventory?      A. Yes.

Q. And in order to clarify that, when was all the wine, or substantially all the wine disposed of that was from the 1945 crush?

A. I believe by the end of June.

Mr. Boyle: What year?

The Witness: 1946.

Mr. Burnstein: I believe that is all.

The Court: You may step down.

(Witness excused.)

The Court: Mr. Burnstein is there something you would like to explain about the stock being held in escrow?

Mr. Burnstein: Yes, your Honor; if I may, I will be sworn.

The Court: Yes.

Whereupon,

ROBERT C. BURNSTEIN

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address for the [92] record.

The Witness: My name is Robert C. Burnstein; my address is 414-13th Street, Oakland, California.

Direct Examination

The Witness: On or about September 18, 1946, an application was filed before the Commissioner of Corporations of the State of California, the Department of Investments, for the issuance of stock to Mills Winery, a California corporation.

At the time the application was filed by reason of services that were rendered by the officers to the corporation, a request was made for the issuance of promotional stock, which was fixed on the face of the corporation minutes as being worth a certain sum.

The Commissioner under the Corporate Securities Act of the State of California, has a right to issue what is called promotional stock for services rendered in connection with the development, promotion and enhancement of the corporation. That permit was issued. However, since the promotional stock——

(Testimony of Robert C. Burnstein.)

By the Court:

Q. How much did they ask for, promotional stock, how many shares?

A. Approximately \$1,350,000 in promotional stock.

Q. The idea being that was to be issued to them for their services in promoting the corporation?

A. That is right. [93]

Q. They didn't have to put in any capital for that? A. No.

Q. To issue \$1,350,000? A. Yes.

Q. Which would be 13,500 shares if it had a par of 500?

A. No; your Honor, let me explain that. Mr. Kershaw was wrong, so your record is correct. There are 20,000 shares that is the authorized issue of this corporation at \$100 par value, the aggregate par value of this corporation is two million dollars.

Q. How do you get that?

A. 20,000 shares at \$100 par is two million.

Q. I don't follow you. I thought you meant the promotional stock?

A. No; that is the aggregate par value.

Q. How much of the authorized capital stock was issued?

A. All of the authorized capital stock was issued, two million dollars.

Q. To whom?

A. To Robert J. Azevedo as to one-half and Paul Kershaw, Jr., as to one-half, 10,000 shares

(Testimony of Robert C. Burnstein.)

each under a permit issued by the Commissioner of California.

Q. That is separate and apart from the promotional stock; is that right?

A. No; included in the 20,000 shares is the promotional—— [94]

Q. 20,000? A. Included within the——

Q. 20,000 shares includes the 13,500 shares of promotional stock?

A. Approximately that, your Honor. I could get you the exact figures if you wanted them. There was a little over a million dollars promotional stock issued.

Q. That would be around \$6,500 for the stock that would be issued for paid-in capital. That would be the difference between promotional stock and total authorized stock.

Well, go ahead with your story.

A. As a result of this type of application, the laws of the State of California require an escrow which does not require any written agreement; all it does require is that stock be handled and held by some person designated by the corporation which can't then be transferred by the holders of the stock which is in escrow unless the purchaser signs a written agreement stating that they understand the stock is in escrow and know the conditions of the escrow.

The conditions of the escrow under the Corporate Securities Act of California, and they are almost identical as that when the net worth of the cor-



(Testimony of Robert C. Burnstein.)

poration is equal to less than the par value of the stock; the promotional stock and all the other stock tied up with that must be held in escrow, and can't be then reissued out of escrow until an application has [95] been filed that the net worth of the corporation is equal to the outstanding par value of all stock.

Mills Winery, unfortunately, by many reverses, has not reached that point, and we are not eligible to apply for the release of stock in escrow.

Q. That explains that?

A. Yes, your Honor.

The Court: Would you like to ask any questions, Mr. Boyle?

Mr. Boyle: No, your Honor.

The Court: Thank you, Mr. Burnstein.

(Witness excused.)

The Court: Well, we have some exhibits here. I believe there is no more evidence to be presented?

Mr. Burnstein: That is right your Honor.

The Court: Mr. Burnstein, I think you did not understand that you must plead the statute of limitations. The exhibits show that the deficiency notice which was mailed on May 13, 1953, in 49929, and 49928 and 49896, all of those deficiency notices were mailed more than five years after the filing of the returns of Irene and Paul Kershaw and Robert Azevedo.

Therefore, the deficiencies are barred by the statute of limitations unless each taxpayer omitted

from gross income an amount properly includable therein which is in excess of 25% [96] of the amount of gross income stated in the return. In that event, under the provisions of Section 275-C for 1939 Code, the taxpayer assessed, and so forth, at any time within five years after the return was filed.

Well, my understanding of the time when the deficiency notice was issued must be wrong. I assumed that the deficiency notice was issued within five years after the return was filed and that three-year period expired. The regular period is three years. You didn't plead the statute of limitations in your petition, and you must do so.

Mr. Burnstein: Yes, your Honor.

The Court: And will you agree to amend your petition and properly plead the issue?

Mr. Burnstein: Yes, your Honor.

The Court: And is your office in Oakland?

Mr. Burnstein: Yes.

The Court: I do not like to ask you to come over again, but you could mail that to the Court. It would reach us and I am sure Mr. Boyle has no objection to your perfecting your pleading. Mr. Boyle, you would be allowed the usual time within which to amend your answer. You have proceeded this afternoon with the understanding that you have the burden of proof because of Section 275; is that not true?

Mr. Boyle: That is true, your Honor.

The Court: On the matter of your answer, I understand [97] that you have an alternative con-

tention. Do you expect to argue that on briefs and that you believe the issues drawn by the pleadings were broad enough for you to advance an alternative contention? We have been over that, and the Court is still of the opinion that you ought to amend your answer. You can amend your answer now on the basis of conforming to the evidence of record, if you wish to.

State your objection, if you believe you have one, Mr. Burnstein. I want to give you the opportunity to state your objection.

Mr. Burnstein: Yes, your Honor. I wish to state for the record that when a request is made to amend, of this type of amendment and the Court normally has the right to permit the amendment with wide discrepancy, and many cases have held that they may do it at the time of the hearing, I respectfully submit that those cases that permit your Honor to permit an amendment at the time of the hearing can only be done when there is evidence of surprise on the part of the Commissioner; that he has been taken by surprise by reason of certain evidence that has come out from depositions or other things of that nature.

I do not believe that the motion to amend of this type could be permitted by the Court in her discretion and within its discretion where there is no showing that this was not known by the Commissioner long before the issues were fixed and [98] raised by the various pleadings.

The Court: Mr. Burnstein, if this motion to amend the answer would put any burden of proof

on you, I would hesitate to grant it, but it is an affirmative pleading of the respondent in his answer, and he has the burden of proof of it.

Mr. Burnstein: Yes, your Honor.

The Court: And if he hasn't met his burden of proof, raising the point wouldn't do any good.

Mr. Burnstein: Quite true, your Honor.

The Court: As I understand it, he feels that this point is one that can be dealt with under the general evidence, under your general stipulation. You know what the point is that he has?

Mr. Burnstein: Yes, your Honor.

The Court: And you know that he is relying upon the stipulation of facts, and the evidence that he has before us. I think it is proper to allow him to amend his answer. If allowing him to amend his answer, Mr. Burnstein, really necessitates your introducing any evidence, and if you are not prepared to introduce that evidence that is something that I can consider. In this sort of thing we are concerned with proof.

Mr. Burnstein: Yes, your Honor. To be fair with Mr. Boyle, I don't have any evidence that I would introduce even if your Honor permitted the amendment. I will be very [99] honest and frank about that.

The Court: You don't need to worry about being so fair to Mr. Boyle. You want to be concerned about the Court because I don't want to have an issue before me to decide if there is going to be failure of proof. I want to be sure that I have given you the opportunity to present all the evidence that

you need to. That is my point, and if you needed to present some evidence and you couldn't do it, if I allowed Mr. Boyle to amend his answer, then I want to allow him to amend his answer.

I would say his proposal was untimely because it didn't give you time to introduce evidence, and I don't like to have issues before me which I decide on the basis of failure of proof. That is why I ask the question. But you say that you don't intend to offer any evidence on this, and that this is strictly a matter of getting our issues in a row, properly under the pleadings.

With that understanding, if you will ask to amend your answer orally, and then reduce that amendment to writing, you will have two things to cover in your amended answer, and you may get that to the Court at some point.

Mr. Boyle: If your Honor please, I request permission to amend my answer to include a reliance upon Section 275-C, due to the fact that petitioner is going to amend his petition to plead the statute of limitations. [100]

I further request permission to amend my answer to argue in the alternative a legal theory in this case, and my grounds for that are to amend the pleading to conform to the proof.

Mr. Burnstein: Your Honor, may I make one short statement in that regard?

The Court: Yes.

Mr. Burnstein: I believe, your Honor, if I understand Mr. Boyle correctly, if he is going to make an amendment to conform to the proof—maybe this



is not the time your Honor wants to hear this, but I don't think, from what he has, that he has sustained the burden of proof under this alternative plan of his, or this contention, and I respectfully submit that an affirmative defense must state some sort of affirmative cause of action, which it doesn't, from what I have heard here today, if the Court please.

Mr. Boyle: If your Honor please, I don't think, in the first place, that this is a situation where it is necessary to amend the pleadings. The alternative legal argument is going to produce less deficiency than is already asserted against these individuals and in many cases we argue alternatives without——

The Court: But your alternative argument is that each taxpayer has realized some taxable income in some way?

Mr. Boyle: That is right. [101]

The Court: And therefore he is taxable on it. How does he realize this taxable income in a lower amount, if your first proposition is not sustained?

Mr. Boyle: If your Honor please, that would be the purpose of the alternative argument, that if the Court holds against the Commissioner——

The Court: The reason why it has could be covered by the pleadings; the taxpayer has a right to defend himself against that alternative determination of realization of income. He has a right to say, "I didn't get that amount of income. I didn't get any amount of income."

Mr. Boyle: Well, if it would help your Honor,

this is not—we have discussed this previously and it is not new to the petitioner.

The Court: It is all new to me. If I read your pleadings, I don't get anything. I wish counsel would remember that when they come into Court they are finished dealing with each other. Now you are dealing with the Court, and the Court wants to know these things because the Court has to decide the question.

Mr. Boyle: This is a matter we couldn't stipulate to, and respondent is determined to go ahead in this fashion and introduce what——

The Court: You don't have to stipulate everything. What is the point? What is this alternative contention of yours, [102] anyway?

Mr. Boyle: The alternative contention will be, your Honor, that if the Court decides against the Respondent on the main issue—in other words, if the Court determines that the income we have in question was actually the income of the corporation and not of the individuals as asserted in the statutory notice, that then, nevertheless, the individuals did realize income to the extent that the corporation paid obligations of the individuals, namely, 55,000 for Robert Kershaw and 55,000 for Robert Azevedo, and 55,000 for Paul Kershaw.

The Court: Well, that is a new issue. If I owe Mr. Burnstein \$1,000 and you pay Mr. Burnstein \$1,000 and get him to discharge me from my obligation, I have realized income of \$1,000, but a fact has to be established there and that is that I owed Mr. Burnstein \$1,000.

Now, what indebtedness are you talking about? You say that if we regard the corporation as being a taxable entity in a period on March 4, 1946, beginning then, then three individuals or two individuals realize some income because the corporation paid some of their debts.

What debts are you talking about and what amount?

Mr. Boyle: If your Honor please, in the basic agreement of December, 1945, it was agreed that Robert Azevedo and Paul Kershaw, Jr., would pay John Azevedo \$100,000 as adjusted basis in the property. The evidence also shows that those [103] payments were made to John Azevedo during a period after March and, therefore, if the Court should hold that this was income from the corporation during that same period then the corporation in fact will have paid that amount.

The evidence further shows that——

The Court: Mr. Boyle, do you agree? You have stipulated and agreed that a partnership existed consisting of Robert and Mr. Kershaw?

Mr. Boyle: We have.

The Court: Have you stipulated to that?

Mr. Boyle: Yes.

The Court: Was that obligation an obligation of those individuals as members of the partnership, because if it was, if the partnership business was taken over by the corporation, the corporation would take over assets and liabilities, and it would issue stock to the members of the partnership in

some amount for the net value of the partnership business.

We get back to the court's concern which began this morning when I told you that although you have stipulated some facts you have not stipulated complete facts on topics such as this: How much corporate stock was issued to somebody, and for what? If one-half of the corporate stock was issued to Robert and one-half to Kershaw, what did they give to the corporation for that stock? Did they give money? Did they give the net worth of a partnership business, or what? [104]

There isn't any agreement that shows that one share of stock was issued to one of these people.

Mr. Boyle: Without regard to the stock, your Honor?

The Court: So you have entered into a stipulation which stipulates some facts, but it doesn't cover every possible fact. Well, all right. You are raising that issue in an amended answer.

I understand you are making a motion to amend your answer to that effect; your motion is granted. You will please reduce your proposal to writing. I must have written pleadings. You may file your amended answer as soon as convenient. It will be served on the petitioner. You have raised the question; you have the burden of proof on it.

If the evidence is insufficient to establish these things then you will lose for failure of proof and that is all we can do about it.

The Court: I think the dates for the briefs we have been using go something like this: Original

brief around August 19, but I believe Mr. Boyle had another case on my calendar, and probably he would like to have his brief in this case due a little later. So why don't I make it around the end of August?

What would be a day in August that doesn't come on Saturday or Sunday?

The Clerk: August 29 is a Monday, your Honor.

The Court: I notice that I am going to get a suggestion [105] on that, so I will wait. Mr. Boyle, what is your suggestion?

Mr. Boyle: If your Honor please, the case I had yesterday, the first brief is assigned September 12, and I have one more case after this, so I would request, if your Honor doesn't mind, a brief at a later date.

The Court: I would prefer giving you a date and if you can't make it, file a motion for an extension of time, otherwise it gets to be so late when the briefs are in.

August 29 for the original brief; they want 30 days, what would that be?

The Clerk: September 28.

The Court: September 28 for the reply brief. That is all. Please make a note about these amended pleadings that will be received. If you will wait a few minutes the Court will give you that return so you can have it photostated. Where will you send the photostats, to Washington?

Mr. Boyle: We will have it photostated here and I will give it to the clerk.

The Court: The clerk may not be here beyond



Friday, and if this session of the Court is extended beyond—or if it has ended, you send it to Washington in the usual way.

Mr. Boyle: Yes, your Honor.

The Court: We had 1-A and 2-B marked for Identification, and you want this in evidence. There is no objection as it is a joint exhibit. I want to understand once and for all, [106] is 1-A supposed to be an agreement of sale or is it supposed to be a partnership agreement?

Mr. Boyle: It is my understanding that it is an executory contract which purports to be an agreement of sale.

The Court: But it doesn't purport to be a partnership contract?

Mr. Boyle: That is true.

The Court: 1-A is received in evidence. What about 2-B? Does that purport to be a partnership agreement?

Mr. Boyle: No, your Honor; it has no significance to the respondent. It is merely put in as background to complete the written transaction.

The Court: May I call your attention to the fact that that is a carbon copy of something that shows no signatures; that there is no proof that that purported agreement was ever executed by anybody?

Mr. Boyle: Yes, your Honor.

The Court: What weight do you expect the Court to give to it?

Mr. Boyle: None, your Honor. The respondent attaches no significance to it except to——

The Court: Well, Mr. Boyle, don't be so agreeable. Whose exhibit is this, please? Is it Mr. Burnstein's?

Mr. Burnstein: It was originally suggested by Mr. Boyle. He asked me to get it for him and I did.

The Court: It is Mr. Boyle's exhibit? [107]

Mr. Burnstein: Yes; I said, "If you want it, you can have it." That is the most important exhibit on the revenue agent's report from the information we have, and I don't know why.

The Court: I am going to read this into the record. It has been marked for identification:

"Here is an agreement that purports to be an agreement made and entered into on the first of December, 1945, by John Azevedo, doing business as Mills Winery and Paul Kershaw, Jr., and Robert Azevedo. The consideration of John Azevedo selling Mills Winery and its assets to Paul Kershaw and Robert Azevedo, and under this agreement as part of the consideration, Paul Kershaw and Robert Azevedo agree to a sum and pay any judgment or judgments which may arise."

Mr. Kershaw has gone?

Mr. Burnstein: He went back to Sacramento, your Honor.

The Court: Was this agreement executed?

Mr. Burnstein: Your Honor, as I told Mr. Boyle previously——

The Court: Just answer my question.

Mr. Burnstein: I don't know.

The Court: Was an agreement of this kind ever executed?

Mr. Burnstein: I do not know. The first I heard of [108] it was from Mr. Donohue, the revenue agent.

The Court: Why don't you find those things out when you come in to try a case?

Mr. Burnstein: I didn't think it had any significance to our case. They wanted it and I said I would join in with the exhibit.

Mr. Boyle: It is agreeable that it be removed from the record.

The Court: Well, it is an important exhibit, Mr. Boyle.

Do you have a number twelve? Somebody told me we had No. 12.

Mr. Boyle: Yes; this could be 2.

The Court: I am talking about something else. Do you have a 12? We are missing Exhibit 12.

Mr. Boyle: If your Honor please, I believe that was the——

The Court: If we don't have a 12, I will change the number on that.

Mr. Boyle: That is the original of the 1946-'47 corporate return, if you recall.

The Court: Where is it?

Mr. Boyle: This should be 12 instead of 13.

The Court: I am Division 13 of this Court. All respondent's exhibits are marked with letters. That is your [109] Exhibit L. We don't have any 12. You misinformed me. Does L fit into this picture all right?

Mr. Boyle: Yes.

The Clerk: That number would just be missing then.

The Court: Let the record show that the agreement with Southern Pacific Company, May 11, 1946, is Exhibit 12 instead of 13, and the agreement of May 23, 1946, is Exhibit 13 and not 14.

We have lost sight of some exhibits.

Mr. Burnstein: There is one other exhibit I think you want to correct the number on.

The Court: No. You be seated for a few minutes and we will get the clerk to work this out.

I will receive 2-B in evidence for whatever its worth. It's a pretty poor exhibit, I must say.

We have all the exhibits now. You have the dates for your briefs and that will conclude the hearing.

Mr. Burnstein: May I ask a question?

The Court: No. We are finished.

Mr. Burnstein: There is one exhibit missing.

The Court: No, there is not. We will give you the numbers in a minute. That is all, thank you.

(Thereupon, at 4:30 p.m. the hearing in the above-entitled matter was concluded.) [110]

State of California,  
County of San Francisco—ss.

### Reporter's Certificate

I, Roland J. Rehrauer, 12 Geary, San Francisco, California, Reporter pro tempore of the Tax Court of the United States, Division 13, under its reporting contract, Do Hereby Certify:

That as such reporter I was present in Division 13 of the above-entitled Court, in session in the City of San Francisco, on Wednesday, the 29th day of June, 1955, and then and there took verbatim stenotype notes of all testimony, colloquy, statements, and every matter constituting the proceedings on the above date in the case of Robert Azevedo, Irene Kershaw and Paul Kershaw, Jr., Petitioners, Dockets Nos. 49896, 49928 and 49929, fully, completely and accurately, to the best of my ability, and that my stenotype notes are full, complete and accurate.

That the foregoing transcript, consisting of pages numbered 1 to 110, both inclusive, contains a complete, true and correct transcription of my said stenotype notes so taken as aforesaid, and a full, true and correct statement of the testimony given and of all of the proceedings had upon the trial of the above-entitled proceedings, to the best of my knowledge and ability.

July 6, 1955.

/s/ R. J. REHRAUER.

Filed July 13, 1955, T.C.U.S. [111]



[Title of Tax Court and Cause.]

Docket Nos. 49896, 49928, 49929

### CERTIFICATE

I, Ralph A. Starnes, Chief Deputy Clerk of the Tax Court of the United States do hereby certify that the foregoing documents, 1 to 41, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Designation of Contents of Record" and "Designation of Additional Portions of Record," including Joint Exhibits 1-A, 2-B, 3-C, 4-D, 6-F and 11-K (Numbers 5, 7, 8, 9 and 10 not used); Petitioners' Exhibits 12 and 13, admitted in evidence and Respondent's Exhibits E, G, H, I, J, L, M, N and O, admitted in evidence, in the proceedings before the Tax Court of the United States docketed at the above numbers and in which the petitioners in the Tax Court proceedings have initiated appeals as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceedings, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 27th day of August, 1956.

[Seal]      /s/ RALPH A. STARNES,

Chief Deputy Clerk, Tax  
Court of the United States.

[Endorsed]: No. 15270. United States Court of Appeals for the Ninth Circuit. Robert Azevedo, Irene Kershaw and Paul Kershaw, Jr., Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review Decisions of The Tax Court of the United States.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for the  
Ninth Circuit.

Filed September 5, 1956.

Docketed September 13, 1956.

United States Court of Appeals  
for the Ninth Circuit

No. 15270

PAUL KERSHAW, JR.,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

STATEMENT OF POINTS

The Appellant, Paul Kershaw, Jr., pursuant to Rule 17, Subdivision "6" thereof, does hereby set forth a concise statement of the points on which he intends to rely and further does hereby designate the record on appeal which is material to the consideration of the appeal.

1. Paul Kershaw, Jr., the Appellant herein, and Robert Azevedo as Copartners under the firm name and style of "Mills Winery" were engaged in such business as a copartnership from August 1, 1945, to March 1, 1946.

2. The earnings from the operation of the business known as "Mills Winery" between March 4, 1946, and August 6, 1946, were taxable only to Mills Winery, a California corporation. The Appellant did not receive any constructive dividend nor any equivalent of cash by reason of the corporation, Mills Winery, paying the obligations assumed by it at the time of its incorporation.

3. The three-year statute of limitations on assessments and collections barred the assessment of the deficiency as determined against this Appellant and the Commissioner, the Appellee, has not sustained the burden of proof in proving any alleged omission from the gross income of the Appellant.

Dated September 12, 1956.

/s/ ROBERT C. BURNSTEIN,  
Attorney for Appellant.

[Endorsed]: Filed September 13, 1956, C.C.A.

United States Court of Appeals  
for the Ninth Circuit District

No. 15270

ROBERT AZEVEDO,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

PAUL KERSHAW, JR.,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

IRENE KERSHAW,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

### STIPULATION

It Is Hereby Stipulated by and between Counsel for the respective parties, that the Record on Appeal that is printed and prepared and all original exhibits which were introduced in the Tax Court which are being considered by the Court pursuant to previous stipulation without the necessity of reproducing the same shall be printed and prepared in connection with a companion case, Paul Ker-



shaw, Jr., vs. Commissioner of Internal Revenue; and that the record printed and prepared in connection with said case, namely, Paul Kershaw, Jr. vs. Commissioner of Internal Revenue, shall be the record on appeal to be used by the Court in determining the appeal of the above-entitled matter and that all records printed and produced in the said Paul Kershaw, Jr., vs. Commissioner of Internal Revenue matter shall be consolidated with this pending matter and an additional companion case, namely, Irene Kershaw vs. Commissioner of Internal Revenue.

Dated this 8th day of October, 1956.

/s/ ROBERT C. BURNSTEIN,  
Attorney for Appellant.

/s/ CHARLES K. RICE,  
Assistant Attorney General,  
Counsel for Appellee.

[Endorsed]: Filed October 17, 1956, C.C.A.

United States Court of Appeals  
for the Ninth Circuit District

No. 15270

ROBERT AZEVEDO,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

PAUL KERSHAW, JR.,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

IRENE KERSHAW,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

STIPULATION

It Is Hereby Stipulated by and between Counsel for the Appellant and Appellee, that all of the exhibits introduced before the Tax Court, including all joint exhibits as well shall be considered by the above-entitled Court in their original form and that the said exhibits need not be reproduced for

the purpose of completing the record on appeal in the above-entitled matter.

Dated this 8th day of October, 1956.

ROBERT C. BURNSTEIN,  
Attorney for Appellant.

/s/ CHARLES K. RICE,  
Assistant Attorney General,  
Counsel for Appellee.

[Endorsed]: Filed October 17, 1956.

No. 15,270

United States Court of Appeals  
For the Ninth Circuit

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ROBERT AZEVEDO, IRENE KERSHAW and  
PAUL KERSHAW, JR.,

*Petitioners,*

VS.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

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BRIEF FOR PETITIONERS.

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ROBERT C. BURNSTEIN,

414 - 13th Street, Oakland, California,

*Attorney for Petitioners.*

FILE

FEB 14 1957

PAUL P. O'BRIEN, J.





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No. 15,270

# United States Court of Appeals For the Ninth Circuit

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ROBERT AZEVEDO, IRENE KERSHAW and  
PAUL KERSHAW, JR.,

*Petitioners,*

VS.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

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## BRIEF FOR PETITIONERS.

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### STATEMENT OF FACTS.

John Azevedo prior to 1945 was the owner of the real property and the improvements upon which a winery was located and which had been leased by John Azevedo to persons other than the petitioners herein, to operate and maintain said winery.

In the month of July, 1945, John Azevedo discontinued his lease arrangement with others and commenced the operation as a sole proprietor of the winery on the land owned by him, and did business under the firm name and style "Mills Winery". John Azevedo held all the necessary basic permits to engage in business as a winery, distiller, and seller of wine at wholesale as required by the various government authorities.



On or about August 1, 1945, John Azevedo agreed orally to sell the winery to Robert Azevedo and Paul Kershaw, Jr., at an "adjusted cost". The oral agreement was later reduced to written agreements dated December 1, 1945.

Commencing August 1, 1945, Paul Kershaw, Jr., and Robert Azevedo conducted operations at the Mills Winery in connection with the crushing of grapes for the manufacturing of wine and conducted the same as copartners.

The partnership went into operation immediately after and on August 1, 1945, purchased grapes for the crushing for the manufacturing of wine from monies that were borrowed from the Capital National Bank at Sacramento. This money was borrowed from the bank through arrangements made by John Azevedo. The note was signed by John Azevedo and the total capital necessary for the formation of the copartnership and for the purchase of the grapes for manufacturing of wine was obtained from the Capital National Bank.

The copartnership that was entered into between Robert Azevedo and Paul Kershaw, Jr., on August 1, 1945 came into existence before any wine was made from the 1945 crush. The inventory, namely, the wine that came into existence from the 1945 crush, was the inventory of the copartnership of Robert Azevedo and Paul Kershaw, Jr. The monies borrowed from the Capital National Bank amounted to Four Hundred and Forty Thousand Dollars (\$440,000.00) and it financed the purchase of the grapes for the 1945

crush One Hundred Per Cent (100%). This loan was obtained by John Azevedo for the benefit of the copartnership which was then in existence between Robert Azevedo and Paul Kershaw, Jr., since said copartnership had no line of credit.

After the formation of the copartnership on August 1, 1945, which partnership was by oral agreement, the partners agreed to pay to John Azevedo the cost as "adjusted" \$110,000.00 for the winery. Paul Kershaw, Jr., when the money was made available to the copartnership by the Capital National Bank of Sacramento, went out and bought grapes, and Robert Azevedo was the wine maker. The crush was finished about in the month of December, 1945 and it was at that time that John Azevedo, the father of Robert Azevedo, requested the execution of written instruments to evidence the obligation of the copartners to him that had been incurred in August, 1945. When the crush was completed, a certain amount of work was done by the copartners to finish the wine and to prepare it for market. Markets were sought in January and February of 1946 by the copartners to dispose of the wine in bulk, and it was then that the copartners decided to organize a California corporation, which was done, and they transferred all the assets and the liabilities of the copartnership to the corporation and had prepared a closing income tax return.

At all times prior to the date of the incorporation of Mills Winery on March 4, 1946, Paul Kershaw, Jr., was the partner actively engaged in the development of future sales of wine, and after March 4,

1946, Paul Kershaw, Jr., when contacting fruit processors or wine brokers in connection with the sale of wine, represented himself as a member of the corporation known as Mills Winery and that he was Vice President in charge of sales.

During the operation of the copartnership of Paul Kershaw, Jr., and Robert Azevedo, books and records of the copartnership were maintained, wherein all of the financial transactions and activities of the copartnership were entered in said books, and the books were closed for the copartnership upon the termination thereof and a closing and final partnership income tax return was prepared. The partnership return indicated that the partnership had no inventory at the beginning of its year and had a closing inventory of \$445,467.09. This was the opening inventory of the corporation on March 4, 1946.

That during the operation of the copartnership from August 1, 1945 to March 1, 1946 and after the incorporation of Mills Winery on March 4, 1946 and to and including August 1, 1946, there was a single bank account maintained in the Capital National Bank at Sacramento, California, which account was a commercial account and used for the business operations of the partnership during its existence and for the corporation from March 4, 1946 to August 1, 1946. That at all times from August 1, 1945 and to August 1, 1946, John Azevedo had the sole authority to sign checks and withdraw funds from the bank. All monies that were withdrawn by John Azevedo from the bank account prior to March 4, 1946 were used to pay the

obligations of Paul Kershaw, Jr., and Robert Azevedo as copartners. All monies withdrawn by John Azevedo after March 4, 1946 from the said bank account and all expenditures that were made thereafter were made for the benefit of Mills Winery, a California corporation, which came from the same bank account and was drawn upon by John Azevedo. That all bank loans, warehouse obligations and expenditures for improvements, alterations and additions made on the winery premises and the equipment thereon that were paid for prior to August 1, 1946 were paid for by check drawn by John Azevedo from this same bank account, and that all payments that were made after August 1, 1946 were paid by Paul Kershaw, Jr., as an officer of Mills Winery from this same bank account.

When the corporation, Mills Winery, was organized the corporation opened corporate books and accounts, and the corporation purchased all of the wine that was in existence on March 1, 1946 from the copartners, Robert Azevedo and Paul Kershaw, Jr., and assumed the obligations of the copartnership in connection with the crush of grapes for the manufacturing of wine, the loan obtained from the Capital National Bank of Sacramento and the adjusted cost of the winery premises.

After the corporation was organized Paul Kershaw, Jr., contacted various wine brokers and other persons interested in the wine industry in connection with the purchase of bulk wine, representing himself as Vice President of Mills Winery, a California corporation, and that the corporation had certain types of wines



that could be sold in bulk. The persons whom Paul Kershaw, Jr., contacted after the wine was in a condition to be sold by reason of the finishing of the same, making it ready for the market, were some of the same people who had been previously contacted by Paul Kershaw, Jr., as a copartner with Robert Azevedo that was in existence prior to March 4, 1946. The relationship of Paul Kershaw, Jr., as a Vice President of a corporation as distinguished from a partner with Robert Azevedo in an organization that was likewise doing business under the firm name and style of Mills Winery was brought to the attention of those people who had dealt with Paul Kershaw, Jr., previously as a copartner with Robert Azevedo. Substantially, all the wine that was made from the 1945 crush was sold by the corporation before the end of June, 1946, sales commencing after March 4, 1946. All of the sales of wine that were made during that period were recorded as corporate gross profit in the books and records of the corporation and all expenditures that were made from March 4, 1946 were paid as corporate expenditures and so reflected in the corporate books. The corporate books from March 4, 1946, the date of incorporation, to this date, have been without interruption reporting all sales, expenditures and assets of the corporation, Mills Winery. The corporation, on or about March 4, 1946, opened corporate books and accounts which reflected the corporate gross profit made from the sales of wine from March 4, 1946 to and including this date.



Paul Kershaw, Jr., and Robert Azevedo as copartners did not make any application to the Alcoholic Tax Unit of the Bureau of Internal Revenue for the issuance of any permits to engage in the business of a winery and/or distillery, nor did they as individuals doing business as copartners apply to the State of California for any permits in order to engage in said business as a winery or distillery. A basic permit was applied for by Mills Winery, a California corporation, on May 3, 1946, and to the State of California for the necessary California licenses and permits. On August 7, 1946, the permits authorizing Mills Winery, a California corporation, to manufacture wine and to distill fruit spirits, were issued by the Federal Alcoholic Tax Unit and the California State Board of Equalization. Prior to August 7, 1946, the permits to manufacture wine and to distill fruit spirits were in the name of John Azevedo, an individual.

Upon the organization of the corporation, the main activity of the corporation from March 4, 1946 to the latter part of June, 1946 was the sale of the wine inventory that had been transferred by the partnership on or about March 4, 1946 to the corporation. The total inventory that was owned by the corporation by reason of its purchase from the copartnership was obtained at one single transaction by the assignment and transfer of the same by the copartners, Paul Kershaw, Jr., and Robert Azevedo, to the corporation, and that the inventory was obtained by the corporation at this one instance and was sold to various persons in bulk until it was substantially disposed of in June, 1946.

After June, 1946, and in the months of July and August, prior to the issuance of the basic permits to the corporation, the principal activity of the corporation was attempting to purchase grapes for the 1946 crush which could be carried on by the corporation as a winery and distillery of fruit spirits after it had received its basic permits. The corporation did not, from March 4, 1946, until its basic permit was issued, engage in any manufacturing of wine or distilling of fruit spirits. It merely sold and offered for sale bulk wine which was in its bonded warehouse.

After March 4, 1946, the date of incorporation, the corporation, Mills Winery, in addition to the sale of wine, carried on certain other corporate activities in connection with the corporate affairs, and held meetings of the Board of Directors. Contracts were entered into by the corporation after March 4, 1946 and prior to August 7, 1946, wherein the corporation agreed with various persons relating to obligations and covenants in connection with the corporate activities; employees were hired and responsible managing employees were retained to represent the corporation with various fruit processors, wine manufacturers and distillers, who were interested in or connected with the fruit processing industry.

After the transfer of the assets of the copartnership to the corporation and the liabilities of the copartnership to the corporation at the time of its incorporation, the wine which was the inventory of the corporation at the commencement of the corporation, was sold, and from these profits there was paid the liabilities

so assumed by the corporation, the liabilities directly incurred after incorporation, and there was paid to John Azevedo, a creditor of the corporation, the total sum of One Hundred and Ten Thousand Dollars (\$110,000.00). These payments to John Azevedo were made in the following manner:

March 22, 1946	\$ 5,000.00
April 17, 1946	10,000.00
June 24, 1946	45,000.00
July 4, 1946	50,000.00

The last payment was made to John Azevedo, as above mentioned, on July 4, 1946, and he was still on the premises when paid, having stayed on the premises at the request of the corporation officers, namely, Robert Azevedo and Paul Kershaw, Jr., in order to assist in advice and construction of various improvements on the winery premises that the winery contemplated and did eventually complete.

On September 18, 1946, the corporation, Mills Winery, applied to the Commissioner of Corporations, State of California, for the issuance of 20,000 shares of the capital stock of said corporation at a par value of One Hundred Dollars (\$100.00) per share, or an aggregate par value of Two Million Dollars (\$2,000,000.00). On October 2, 1946, a permit was issued by the Commissioner of Corporations of the State of California for the issuance of 20,000 shares at One Hundred Dollars (\$100.00) par value, and the corporation did immediately thereafter issue 10,000 shares of the capital stock each to Paul Kershaw, Jr., and Robert Azevedo. At the time the application was

made before the Commissioner of Corporations, Mills Winery had already received its basic permits from the various government authorities, and had been since on or about the 21st day of June, 1946, the named grantee to the real property upon which the winery premises were located.

For the issuance of stock the purchasers, namely, Robert Azevedo and Paul Kershaw, Jr., were to pay to the corporation the sum of Fifty-Five Thousand Dollars (\$55,000.00) each, or a total sum of One Hundred and Ten Thousand Dollars (\$110,000.00). The stock that was authorized to be issued was paid for by the purchasers, namely, Robert Azevedo and Paul Kershaw, Jr., by way of a loan, in that they each borrowed Fifty-Five Thousand Dollars (\$55,000.00) from the corporation which was used at the time for the issuance of stock to Robert Azevedo and Paul Kershaw, Jr.; that is, in consideration for the issuance of the stock One Hundred and Ten Thousand Dollars was paid by Paul Kershaw, Jr., and Robert Azevedo to the corporation. Stock was therefore issued by the corporation to Paul Kershaw, Jr., and Robert Azevedo in equal amounts, namely, Ten Thousand (10,000) shares each, for one Hundred and Ten Thousand Dollars (\$110,000.00), the payment of which was deferred by reason of the obligation incurred by Paul Kershaw, Jr., and Robert Azevedo as evidenced by the obligation of said Paul Kershaw, Jr., and Robert Azevedo to the corporation amounting to Fifty-Five Thousand Dollars (\$55,000.00) each, or the total sum of One Hundred and Ten Thousand Dollars (\$110,000.00).



Robert Azevedo filed his 1946 United States individual income tax return on March 7, 1947. He executed a consent fixing the period of limitation upon assessment of income and profits taxes on February 26, 1952.

Paul Kershaw, Jr., filed his 1946 United States individual income tax return on March 15, 1947. Paul Kershaw, Jr., executed the consent extending the assessment period on January 22, 1952.

Irene Kershaw filed her United States individual income tax return on March 20, 1947 and she filed her consent extending the period of limitation upon assessment of income and profits tax on January 22, 1952.

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#### **SPECIFICATIONS OF ERRORS.**

1. *The Tax Court erroneously found that the net earnings arising from the sale of wine from March 4 through August 6, 1946 were compensation to the petitioners under agreements dated December 1, 1945 marked Exhibits "1-A" and "2-B" in evidence respectively.*

2. *The Tax Court erred in finding that Mills Winery, a California corporation, was not the owner of an inventory of wine prior to the sale thereof and thus, the proceeds from the sales of said wine were not corporation income.*

3. *The Tax Court erred in making finding and rendering a decision based upon facts inconsistent with*



*the stipulation entered into between petitioners and respondent.*

4. *The Tax Court erred in not finding that the deficiencies assessed by the Commissioner of Internal Revenue were barred by the Statutes of Limitations and by finding the respondent has sustained the burden of proof under the chief issue before the Tax Court.*

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## I.

### ARGUMENT.

ROBERT AZEVEDO AND PAUL KERSHAW, JR., AS COPARTNERS  
UNDER THE FIRM NAME AND STYLE OF MILLS WINERY  
WERE ENGAGED IN SUCH BUSINESS AS COPARTNERS  
FROM AUGUST 1, 1945 TO MARCH 1, 1946.

It is important for the Court to note that there was a certain period of time when the taxpayers, Robert Azevedo and Paul Kershaw, Jr., were admittedly engaged in a business as copartners. This is important since the respondent chiefly relies upon the agreements that were entered into between Paul Kershaw, Jr., Robert Azevedo and John Azevedo, on December 1, 1945. (Ex. 1A and 2B; Trans. of Record, page 66.) It should be noted however that the agreements in themselves do not create any copartnership and are merely buy and sell agreements. Therefore, the copartnership that existed between Paul Kershaw, Jr., and Robert Azevedo, which is admitted by the respondent, and which likewise is admitted became effective August 1, 1945, was a result of an oral agree-

ment between the said copartners. (Trans. of Record, page 148.) The terms of the agreements dated December 1, 1945 (Ex. 1A and 2B) do not alter the admission that a partnership existed. If the contracts of December 1, 1945 were carried out in accordance with their terms it would simply mean that John Azevedo, as the owner of Mills Winery, had agreed to sell the winery for a certain price, determined in a certain manner, and that during a certain period of time purchasers, namely, the petitioners, would receive as compensation for the management of the winery, the earnings of said business during that period of time from the date of the management to the day when the individuals, namely, Robert Azevedo and Paul Kershaw, Jr., received certain permits from various governmental authorities. Thus, respondent, to be consistent, would have to take the position that the earnings of the winery during the period of time in question, namely, from March 4, 1946 to August 1, 1946, belonged to John Azevedo, and he paid over said earnings to Robert Azevedo and Paul Kershaw, Jr., for services rendered. Contrary to these written agreements, however, Robert Azevedo and Paul Kershaw, Jr., did not act as mere employees of John Azevedo but did organize a copartnership on August 1, 1945, in order to carry out the activities toward the purchase of grapes and the crushing thereof in the manufacturing of wine for eventual sale in 1946. The fact that John Azevedo, as an individual, was the only person who had a basic permit authorizing him to distill fruit spirits and manufacture wine, does not alter the ad-

mission of the respondent that a partnership was actually in existence and did conduct various activities as a copartnership in connection with the crushing of grapes and the manufacturing of wine. As a matter of fact, Paul Kershaw, Jr., as part of his activity in the copartnership, went out and purchased the grapes from the growers, and Robert Azevedo made the wine, as the wine maker, and the physical assets which had been sold and transferred by John Azevedo to the copartnership were merely incidental to the partnership activities. Nor did the licensing provisions of the *Federal Alcohol Administration Act as amended, Act of August 29, 1953, Chapter 814, 49 Stat. 977 ff 27 USCA Sec. 201* derogate from the fact that a copartnership admittedly was in existence on August 1, 1945, consisting of Robert Azevedo and Paul Kershaw, Jr., even though such copartnership had no license as may be required by said Act. The activities of the copartnership did not consist of distilling fruit spirits nor manufacturing of wine, which required a permit. The wine which was being manufactured was under the permits standing in the name of John Azevedo, as in individual, but the fruits of such activity, that is the eventual existence of an inventory of wine, belonged to the copartnership. No wine was sold until after March 4, 1946, which was the date of the incorporation of Mills Winery, which is likewise admitted by the respondent, and thus as far as the petitioners are concerned, no wine was sold by the copartnership during its lifetime. Because of this fact the partnership did not re-

quire any license to sell wine at wholesale since it was not engaged in the business of purchasing for resale, at wholesale, distilled spirits, wine or malt beverages.

The fact that John Azevedo was the sole person who could draw upon the bank account during the period of time that the copartnership was in existence as contended by the petitioners, namely, from August 1, 1945 to March 1, 1946, does not derogate from the admitted existence of the copartnership. The control of such funds by reason of John Azevedo being the sole person being entitled to draw upon same, in no manner affects the admitted existence of the copartnership since it is likewise admitted that this bank account was used to pay all the obligations of the copartnership while in existence. The right of John Azevedo to draw upon the account of the copartnership was nothing more than a protective provision for John Azevedo which was used in order to prevent any dissipation of monies coming into the hands of the copartners while John Azevedo was concerned because of the obligation that was owed to him when the assets of the winery were sold to the copartners on August 1, 1945. Therefore, notwithstanding the agreements of December 1, 1945, the evidence is uncontradicted that Robert Azevedo and Paul Kershaw, Jr., did as copartners commence certain activities in connection with the crushing of grapes for the manufacturing of wine on August 1, 1945.

The validity of the copartnership and the creation thereof are dependent upon the laws of the State of California, and this court is bound by the laws of the



State of California as to whether a copartnership in fact existed.

*Easton v. George Wostenhelm & Son*, 137 Fed. 524;

*Vogel v. Bankers Building Corp.*, 112 Cal. App. 2nd 160.

It may be wondered by the Court why the petitioners have spent any time on the argument that the petitioners were or were not copartners, since the admissions of the respondent admit the existence of the copartnership. However, it is important to note that the relationship between the petitioners, Kershaw and Azevedo, as copartners was stipulated to and admitted as has hereinbefore been set forth in this first subdivision of Petitioners' Argument by the Stipulation admitted into evidence by the Tax Court.

See:

(Trans. of Record, pages 34, 35 and 40).

The testimony of Paul Kershaw, Jr., is consistent with the Stipulation and is uncontradicted.

See:

(Trans. of Record, pages 131-168).

Thus, the conclusion and opinion of the Court that Azevedo and Kershaw operated the winery for John Azevedo in consideration of the receipt of salary and compensation for their services, that there was no written partnership agreement between Azevedo and Kershaw, forms the entire basis for the Court's opinion and compels the Court to find that there was no



partnership between Azevedo and Kershaw and that the contracts of December 1, 1945 (Exhibit "1A", Exhibit "2B"), were clear and unambiguous agreements establishing the place where the fruits of the business conducted by the parties belonged. This is entirely inconsistent with the Stipulation of Facts admitted into evidence.

See:

(Trans. of Record, pages 70-71);

(Trans. of Record, page 74).

A more detailed examination of the error committed by the Court in making its findings and rendering its decision on an assumption of facts inconsistent with the testimony and the Stipulation admitted into evidence will be developed later in this Petitioners' Brief.

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## II.

### **THE EARNINGS FROM THE OPERATION OF THE BUSINESS KNOWN AS MILLS WINERY BETWEEN MARCH 4, 1946 AND AUGUST 6, 1946, WERE TAXABLE TO MILLS WINERY, A CALIFORNIA CORPORATION.**

On March 4, 1946, Mills Winery, a California corporation, was incorporated under and by virtue of the laws of the State of California, and commenced the operation of its corporate affairs and businesses immediately thereafter. On March 4, 1946, the corporation purchased from Robert Azevedo and Paul Kershaw, Jr., copartners, who were theretofore doing business under the firm name and style of Mills

Winery, all the assets of the copartners, and did then and there assume all of the copartnership liabilities. The partnership prepared its closing return upon the dissolution thereof, closing its partnership books, and the corporation opened its books for the commencement of its corporate affairs. The closing inventory of the copartnership consisting of wine, was the opening inventory of the corporation on the date of its incorporation.

After the organization of the corporation, the wine that was purchased from the copartners was ready for sale on the open market and the wine was thereafter sold between March 4, 1946 and to June of 1946. The sole activity of the corporation in connection with the wine in existence was the sale of same. The corporation did not until after August 7, 1946, distill fruit spirits or manufacture wine. The wine when it was acquired by the corporation was acquired at one instance from a single purchase from the copartners and it was sold to various purchasers in bulk.

At the time the corporation was organized and during the period of time that the wine was sold, the corporation did not have any basic permits authorizing the corporation to manufacture wine or to distill fruit spirits from the necessary governmental authorities. These permits were in the name of John Azevedo, and it was not until May 3, 1946, that the corporation made its application to the Federal authorities for the issuance of a basic permit authorizing the corporation to manufacture wine and to distill fruit spirits, which

would be necessary for the 1946 crush and the sale of wine in 1947. The activities of the corporation in selling the wine that they purchased from the copartners did not require any permit from either the State of California or the United States Government.

The permits required by corporations engaged in the manufacturing of wine, distilling of fruit spirits, and the engaging in business of purchasing for resale at wholesale, wine, requires two separate types of permits. One permit is necessary in order for a corporation to engage in the business of distilling spirits or producing wine. The other permit requires a corporation to be licensed for it to engage in the business of purchasing for resale at wholesale distilled spirits or wine.

(27 USCA Sec. 203 Sub. (b) (1));

(27 USCA Sec. 203 Sub. (c) (1)).

The corporation, Mills Winery, did not become engaged in the business of manufacturing wine or distilling spirits until it did receive a permit on August 7, 1946. The corporation did, however, sell wine which was purchased by it from one instance from the copartners on March 4, 1946, and by reason thereof it did not require any permit. The corporation was engaged in the business of selling wine that it had on hand, which did not require a permit from the United States Government or from the State of California.

*Malt Products Co. v. United States* (1946), 153 Fed. 2nd 5;

*Eastman v. United States* (1946), 153 Fed. 2nd 80.

Therefore, the activity of the corporation was lawful regardless of the fact that a basic permit stood in the name of John Azevedo at the time sales were made by the corporation.

It should be noted by the court that in reality John Azevedo, although on record having a permit, it could have been determined that no later than May 3, 1946, and as early as April 4, 1946, lost his permit and that the corporation, Mills Winery, the owner of wine, was selling said wine without the necessity of a permit and regardless of the existence of a valid permit in the name of John Azevedo or any other person.

(27 USCA Sec. 204 Sub. (g)).

It should likewise be noted by the Court that even if the Court felt that the existence of a permit in the name of John Azevedo had some bearing on the determination of the validity of the assessment made by the Commissioner against the petitioners that the Act under which these permits are issued, namely, *the Federal Alcohol Administration Act*, 49 Stats. 977, does not prohibit the successor of an existing permittee to operate under the existing permit when an application is filed within a specific time required by statute. The corporation here, however, by approximately Thirty (30) days, failed to comply within the statutory time but the fact that such may be done indicates to the Court that this is not a case where the activities are *malum in se*.

(27 USCA Sec. 204 (g)).

To finally dispose of the question of the license, if we assume for the purpose of argument that Mills



Winery, a California corporation, was conducting activities in the sale of wine which were in violation of Federal and/or State statutory requirements, this does not permit the Court to disregard the corporate entity and to determine that the income earned during the period in question is not properly allocable to the corporation. Income is taxable to an individual or a corporation where the facts justify the assessment against such corporation or individual, regardless of the legality of the transaction which gave rise to the income.

*Barker v. United States*, 26 Fed. Supp. 1004;  
*Patterson v. Anderson*, 20 Fed. Supp. 709.

The primary question then for this court to decide is whether or not the corporation, Mills Winery, had any "flesh on its bones" or was it a mere shell or sham during the period in question.

The doctrine of corporate entity fills a useful purpose in business life, whether the purpose be to gain an advantage under the laws of the state of incorporation or to comply with the demands of creditors, or to serve the creator's personal or undisclosed purpose, so long as that purpose is the equivalent of a business activity and is followed by the carrying on of business by the corporation. If such occurs, the corporation remains a sound, separate, taxable unit.

*Moline Properties v. Commissioner*, 319 U.S.  
 436.

The respondent had admitted that the corporation, almost immediately after its incorporation, held its



first organizational meeting. (Stip. Par. 9; Trans. Record, page 38); that contracts were entered into between the corporation and certain persons in connection with distilling fruit spirits during the 1946 fruit season (Stip. Par. 10, Ex. 6F; Trans. of Record, page 38); contracts were entered into between the corporation and the Southern Pacific Co. (Stip. Par. 10, Exs. 12 and 13; Trans. of Record, page 38); a grant deed was executed and dated June 21, 1946, by John Azevedo and Frances Azevedo as grantors and the corporation as the grantee (Stip. Par. 11; Trans. of Record, page 39); that corporate expenditures were made and corporate obligations were incurred between March 4, and June 1946, all of which were paid out of the bank account which was drawn upon by John Azevedo until August 1, 1946; that bank loans that were assumed by the corporation when purchasing the assets from the copartnership composed of Robert Azevedo and Paul Kershaw, Jr., were paid from the corporate bank account; that warehouse obligations, expenditures for improvements, alterations and additions to the winery were made by the corporation from March 4, 1946, to August 1, 1946, which were paid from this single bank account (Stip. Pars. 12 and 13; Trans. of Record, pages 39-40); employees were employed by the corporation, who represented the corporation in their corporate employment capacity from April 1946 (Stip. Par. 17; Trans. of Record, page 4); that all sales of wine that were made during the period from March 4, 1946 to August 6, 1946 were recorded as corporate gross profit and that all expenditures that were made from and after March

4, 1946, were paid as corporate expenditures, and that the books of the corporation were opened on March 4, 1946 and the gross income from and after March 4, 1946, and the expenditures made from and after March 4, 1946, were recorded and picked up as corporate transactions (Stip. Par. 23; Stip. Par. 25; Exs. 4D, 11K; Respondent's Answer Sub. Par. (p) of Par. 5; Trans. of Record, pages 40, 42-43; 25).

The corporation reported in their income tax return and the amended return for the fiscal year beginning March 4, 1946 and ending March 3, 1947, all the income earned as a result of the sale of the wine by Mills Winery that arose from the wine manufactured from the 1945 crush. (Stip. Par. 22, Exs. 4D, 11K; Trans. of Record, page 42).

Thus, the corporation did carry out admittedly various corporate activities. The fact that the corporation did not have all of the elements that go into the "bundle of sticks" attributed to a complete and unequivocal activity as a corporation, did not detract from the fact that admittedly the corporation was not a mere shell or sham. The Courts cannot reasonably ignore the existence of a corporation if it is an immutable fact.

*Crocker v. Commissioner of Int. Rev.*, 34 Fed. 2nd 64. In order for a corporation to be a separate jurial person, it is necessary that a corporation must engage in some industrial or commercial activity. Thus even though a corporation has been called a "shell", if the "shell" has some industrial or commercial activity connected there-

with, it is in business as a business activity, which the courts cannot disregard and must recognize as a separate taxable unit.

*National Investors v. Koey*, 144 Fed. 2nd 466. Only under very exceptional circumstances can the separateness of the corporation from the stockholder be disregarded, even when there is just one stockholder.

*Ross v. Commissioner Int. Rev.*, 129 Fed. 2nd 310. The fact that a corporation did not keep any books, did not have any bank account, that it used a name similar to a predecessor copartnership, that the same books were kept by a copartnership and then by a successor corporation, the fact that certain assets being used by a corporation in its corporate activities stand on record in the name of an individual shareholder, would not permit the court to ignore the separateness of the corporation as a taxable entity from its shareholders.

*Moline Properties v. Commissioner*, *supra*;

*Crocker v. Commissioner Int. Rev.*, *supra*;

*Vaughan Lumber Co. v. U. S.*, 103 Fed. 2nd 885;

*Burnet v. Clark*, 287 U.S. 410;

*Dalton v. Bowers*, 287 U.S. 404;

*Burnet v. Commonwealth Imp. Co.*, 287 U.S. 415.

*Standard Oil Co. v. United States*, 130 Fed. Supp.

821. The courts are not concerned with refinements of title and the nonexistence of certain of the elements relating to the corporate activity that the respondent has contended by reason of

their absence has made the corporation a mere sham and shell. What was done with the income, the command over the income, and the realities of the relationships between the parties, will determine the taxable entity.

*Austin v. Commissioner of Internal Revenue*, 161

Fed. 2nd 666;

*Fordyce v. Helvering*, 78 Fed. 2nd 525.

The fact that there were no formal words of assignment or transfer of the assets and liabilities by the copartners to the corporation on the day of its incorporation, namely March 4, 1946, is immaterial. The admitted facts are that the wine was sold and that the profits were used for corporate obligations. The uncontradicted testimony is that the wine was sold by Paul Kershaw, Jr., on behalf of the corporation as an officer in charge of sales. Thus, from the uncontradicted testimony, and the admissions which were set forth in the stipulation, the intention of the parties was clear, and that is enough. There is no evidence, nor any testimony, that there was any fraud involved, and thus, fraudulent pretenses being absent, the government accepts the taxpayer as it represents itself to be, and thus, represented as a corporation, it must make its return and pay its taxes accordingly.

The Tax Court seemed to place some emphasis upon the fact that issuance of stock by Mills Winery, a California corporation, was not authorized and issued until October 2, 1946. The only apparent intention that the Court would have in referring to this factor



in arriving at a decision that the corporation was not the taxable entity and entitled to the income arising from the sale of the wine during the period as set forth herein, would be that the mere failure to issue corporate shares within a certain period of time would constitute an abortive attempt to organize a corporation.

This, however, is not the law of the State of California. California has recognized that the failure on the part of the directors to obtain a stock permit does not make of them a copartnership or a joint adventure. Thus, corporate activities conducted by the corporation as found by the Court and as contained in the Stipulation of Facts (Trans. of Record, pages 33, 34, 38, 39, 40, 42 and 43; Trans. of Record, page 149) evidently could not be diminished, or their weight and competency reduced, merely because stock was not issued until after August of 1946.

See:

*Vogel v. Bankers Building Corporation*, 112 Cal. App. 2nd 160;

*Blanchard v. Kaull*, 44 Cal. 440;

*I. W. Williams Co. v. Leong*, 44 Cal. App. 296.

Apparently, once again the Court completely disregarding the Stipulation of Facts admitted into evidence concludes that the wine inventory when the same was sold was still owned by John Azevedo and that Robert and Kershaw were in the nature of mere employees receiving the net profit as compensation for services rendered to John Azevedo. This is the illog-



ical conclusion drawn by the Court from facts which do not sustain the Court's findings and as a matter of fact, contrary to the stipulation entered into between the petitioners and respondent which was admitted into evidence. The income was produced by property owned by the corporation at the time the income arose and thus, it was taxable to the corporation and returned and so reported by the corporation.

See:

*Blair v. Commissioner*, 300 U.S. 5.

It is submitted therefore that from all the evidence before this Court consisting of both oral and documentary in addition to the stipulations it is contradicted that the representations to the business world were that the wine from March 4, 1946, to June, 1946, when substantially disposed of was being sold by the corporation. The fact that the income to the corporation resulted from the personal services of the same persons who were previously copartners does not minimize the existence of the corporation as a jurial entity.

*Fontaine Fox*, 37 B.T.A. 271;

*Esmond Mills v. Commissioner of Internal Revenue*, 132 Fed. 2nd 753.

The corporation, Mills Winery, therefore, and not the petitioners as individuals, properly reported the earnings resulting from the sale of wine in 1946.

## III.

THE EVIDENCE BEFORE THE TAX COURT CONSISTED OF STIPULATION OF FACTS, EXHIBITS, TESTIMONY OF KERSHAW AND ROBERT C. BURNSTEIN. THE COURT DISREGARDED THE TESTIMONY OF KERSHAW, THE STIPULATION OF FACTS AND SUPPLIED FACTS INCONSISTENT WITH BOTH THE STIPULATION OF FACTS AND THE TESTIMONY TO ARRIVE AT ITS DECISION.

The Stipulation of Facts entered into between petitioners and respondent provided in its opening statement as follows:

“It is hereby stipulated by and between the parties hereto by their respective counsel that the following facts shall be taken as true without prejudice to the right of either party to introduce other and further evidence not inconsistent therewith.”

(Trans. of Record, pages 32-33).

Certain important stipulations were entered into which formed the basis upon which the petitioners proceeded and which have established an unsurmountable admission on the part of the respondent. This, the petitioners respectfully believe may have been recognized by the Court when arriving at its decision but unfortunately, it is not for the Court after such stipulations and admissions have been admitted into evidence to disturb the admitted evidence to be considered by the Court. Specifically, the stipulation established certain major premises which were distinguished by the Court in its decision. These stipulations are as follows:

1. *“Immediately thereafter and commencing August 1, 1945 the said Paul Kershaw, Jr. and*

*Robert J. Azevedo conducted the operations in connection with the crushing of grapes for the manufacturing of wine and carried out said operations to and including March 1, 1946 as copartners at which time the said Robert J. Azevedo and Paul Kershaw, Jr. had prepared for filing with the Internal Revenue Department of the United States a partnership income tax return. That attached hereto and marked Exhibit 3C is a photostatic copy of the U. S. Partnership Return of Income prepared for filing by Paul Kershaw, Jr. and Robert J. Azevedo with U. S. Treasury Department for the period beginning August 1, 1945 and ending March 1, 1946."*

(Trans. of Record, pages 34, 35).

2. *"That attached hereto and marked Exhibit 4D and made a part hereof as if set forth in full herein is photostatic copy of the amended corporation income tax return for the fiscal year beginning March 4, 1946 and ending March 3, 1947. That said Exhibit 4D reflects that the inventory at the beginning of the corporate Fiscal Year, namely March 4, 1946, amounted to \$445,467.09 which was the same amount that was reflected in the partnership return of income as the closing inventory of said copartnership on March 1, 1946 as is more specifically set forth in Exhibit 3C hereinbefore referred to."*

(Trans. of Record, pages 34-35).

3. *"A financial statement prepared for the partnership on March 3, 1946 and prior to the date of incorporation of Mills Winery, a California Corporation, shows the following:*

*Paul Kershaw, Jr., and Robert J. Azevedo  
d.b.a. Mills Winery, Route 2, Box 2851B, Sac-  
ramento, California,*

*Financial Statement*

March 3, 1946

Assets—

Inventory	\$445,467.09
Plant and Equipment	108,225.19
Land	5,000.00
Deferred Charges (Insurance)	1,542.82
	<hr/>
	\$559,235.10

Liabilities—

Capital National Bank (O.D.)	\$ 2,246.01
Accounts Payable	310,734.01
Accrued Taxes	55.08
Notes Payable	136,200.00
Reserve for Depreciation	None
Investment	110,000.00
	<hr/>
	\$559,235.10

Prepared without audit

Prepared by National Accounting Service,  
Los Gatos''.

(Trans. of Record, pages 35-36).

4. "All monies withdrawn by John Azevedo from said bank account prior to March 4, 1946 were used to pay the obligations of Paul Kershaw, Jr. and Robert J. Azevedo as copartners and all monies withdrawn by John Azevedo after March 4, 1946 from said bank account and all expenditures that were made thereafter were made for the benefit of the corporation which came from the Bank account except the payments made to John

Azevedo . . . That all bank loans, warehouse obligations and expenditures for improvements, alterations and additions made on the winery premises and the equipment therein that were paid prior to August 1, 1946 were paid by checks drawn by John Azevedo from the single bank account and that all payments that were made after August 1, 1946 were paid by Paul Kershaw, Jr. from the same bank account."

(Trans. of Record, page 40).

5. "That all sales of wine made during the period March 4, 1946 to August 6, 1946 were picked up as corporate gross profit. All expenditures made from and as of March 4, 1946 were paid as corporate expenditures and that the books from March 4, 1946, the date of the incorporation of Mills Winery, a California corporation, to this date have been without interruption reporting all sales, expenditures and assets of the corporation, Mills Winery, a California corporation."

(Trans. of Record, pages 42, 43).

The basic premises upon which the Court makes its decision can be found in the following facts contained in the Court's findings and in its opinion which opinion and findings when compared with the above stipulation of facts are inconsistent therewith and thus cannot be considered as sufficient to sustain the findings and decision of the Court.

1. Contrary to Stipulation "1" above as specifically quoted, the Court made the following findings:

"During the period January 1, 1946 to August 1, 1946, the net earnings of the winery business



known as Mills Winery amounted to \$202,113.82 and these earnings were derived from the sales in the months of March through June, 1946 of the wine made from the 1945 crush. These earnings represented Fifty Per Cent (50%) to each or \$101,056.91 to each, compensation and salary to Robert Azevedo and Paul Kershaw, Jr., respectively for his services in the operation and management of the business known as Mills Winery and for their respective service in making and selling of wine from the 1945 crush . . .”

(Trans. of Record, page 63).

“There was no written partnership agreement between Robert and Kershaw.”

(Trans. of Record, page 70).

“And under the provisions of Paragraph ‘3’ of the agreement of December 1, 1945, Robert and Kershaw had the right to the net proceeds of the sales as their salaries for their personal services in managing and operating the *sole proprietorship business of John Azevedo and in making and selling the wine produced during the period of management by Robert and Kershaw.*”

(Trans. of Record, page 74).

It is thus apparent that the Court, disregarding the conduct of the parties which was admitted to be such conduct that a partnership was entered into between Robert and Kershaw, based its entire decision or at least the major premises upon which the decision was arrived at on the theory that the agreement of December 1, 1945 was controlling, notwithstanding

the stipulation that was admitted into evidence. The agreement of December 1, 1945 had absolutely no probative value to prove that a relationship other than a partnership existed between Robert and Kershaw commencing August 1, 1945. It seems that the Court finds it necessary to disregard the testimony of Kershaw at the time of the hearing and the Stipulation of Facts in order to use the December 1, 1945 agreements as a starting point and then on that basis since a partnership cannot be found arrive at the conclusion that there could not have been any transfer of assets to the corporation from whence the income was produced. In this regard the Court was substantially in error.

2. Contrary to the stipulation of "2" above, as specifically quoted, the Court made the following findings:

"Although Robert and Kershaw caused a corporation to be organized on March 4, 1946, there was no written assignment by Robert and Kershaw or their interest in the agreement of December 1, 1945 to the Corporation and there was no written evidence of assumption by the Corporation of any of the obligations of Robert and Kershaw as purchaser of the real estate and improvements making up the winery premises under the agreement of December 1, 1945."

(Trans. of Record, page 71).

"The mere statement in the corporation income tax return for the period March 4, 1946 to March 3, 1947 which was prepared for the corporation that the corporation had an inventory in the amount of \$445,467.09 on March 4, 1946 is not

competent proof that the corporation in fact acquired and owned inventory of wine which was sold through March through June, 1946 from which sales the income in question was derived.”

(Trans. of Record, page 72).

The stipulation which contained the portion quoted in Paragraph “2” above which was admitted into evidence and the testimony of Paul Kershaw, Jr., which is the only testimony before the Court, is competent proof before the Court that the inventory of the wine owned by the partnership which was admitted by the respondent was sold and transferred to the Corporation prior to the production of income from the sale thereof. See: (Trans. of Record, pages 131-166).

The Court had to completely disbelieve Kershaw which, as the judge of the creditability of a witness, the Court has done, but the Court could not disregard completely nor find inconsistent therewith the facts admitted to be true in the Stipulation. Whether the statements made by the Corporation in its original or admitted return from March 4, 1946 to March 3, 1947 were self-serving or not, that is not the question. This is inconsistent proof to establish a fact upon the admission of the same into evidence by the Stipulation. Therefore, the statement in the corporate return, which was likewise admitted into evidence (Exhibit 4D and Exhibit 11K), is sufficient proof as far as this case is concerned to establish the facts set forth therein. This is especially true when we consider that the respondent had the burden of proof in this case.

3. Contrary to the Stipulation "3" above as specifically quoted, the Court made the following findings:

"It cannot be concluded that Robert and Kershaw owned the inventory of wine which they contend they conveyed to the corporation as of March 4, 1946."

(Trans. of Record, page 73).

"There was no sale of the wine inventory to Robert and Kershaw before the wine was sold and they could not convey the wine inventory to the corporation."

(Trans. of Record, page 72).

Once again the Court, by admitting into the evidence the Stipulation of Facts, which included the Paragraph "3", quoted above, took as competent binding evidence upon the Court that the partnership, consisting of Robert and Kershaw, had a wine inventory of \$445,467.09 prior to the date of the incorporation. This was the same inventory that was reported by the Corporation as its opening inventory and thus, the consistent logical transfer from a partnership to a corporation is reflected in the admitted evidence before the Court.

4. Contrary to the Stipulation marked "4" above, as specifically quoted, the Court made the following findings:

"There was no bank account opened in the name of the corporation as of March 4, 1946."

(Trans. of Record, page 75).



“Furthermore, the authority to draw checks on the bank account of the winery business remained exclusive in John until August 1946 and until then, Petitioners had no authorization to make withdrawals from the account.”

(Trans. of Record, page 75).

Although the Court, in its findings that can be found in the Transcript of Record, page 59, makes a specific finding identical to Paragraph “4”, quoted above, the Court draws a conclusion therefrom in its opinion that the failure to have a separate account in the name of the Corporation and in the name of the partnership to distinguish the secure entities was proof that no such partnership was in existence and further, that the Corporation was not the owner of the assets from whence income was produced. Such a conclusion is inconsistent with the findings and contrary to the admitted fact that, notwithstanding separate and distinct bank accounts, a single bank account was used for partnership obligations during the period of the partnership and for corporate obligations during the period of the Corporation.

The Court cannot disregard the statement in the Stipulation of Facts that all monies withdrawn by John Azevedo from the bank account prior to March 4, 1946 were used to pay the obligations of Robert and Kershaw as copartners nor can the Court disregard the fact that all monies that were withdrawn from this single bank account after March 4, 1946 were used to pay the obligations of the corporation. By giving mere lip service to a finding which must be



taken as true by the Court, and arriving at a conclusion which is inconsistent with and *irreconcilable* with the admitted evidence would do violence to stipulated facts and admitted uncontradicted evidence.

5. Contrary to the Stipulation "5" above as specifically quoted, the Court made the following findings:

"The assertion that the sales of wine in the months March through June of 1946 were made on behalf of the corporation is not supported by any independent proof that this was a fact. For example, books and records of the corporation were not introduced into evidence."

(Trans. of Record, page 72).

"There is no proof that all or part of the net earnings of the winery derived from the sales of the inventory of wine during March through June, 1946, came into the possession of the Corporation."

(Trans. of Record, pages 74, 75).

The stipulation of facts that contained the provisions as quoted above in Paragraph 5, unfortunately had a poor choice of language. The stipulation stated that all sales of wine made during the period of March 4 to August 6, 1946 were "picked up" as corporate gross profit.

It is respectfully believed however that this stipulation itself would be sufficient to sustain the position of the petitioners. Although the choice of language used by both counsel for petitioners and respondent was not the best, the common usage of the term gross

profit "picked up" clearly imported that the gross income arriving from the sale of the wine and thus the resulting net income earned therefrom was considered by and received by, reported by and earned by the corporation.

This finding by the Court which leads the Court to the conclusion that the petitioners had dominion and control over the income is inconsistent with and contrary to the admitted evidence.

This same question as to the corporation receiving income from the sale of wine as corporate income from March 4, 1946 was likewise alleged in the Petition filed by the petitioners for review by the Tax Court.

(Trans. of Record, page 12).

This particular paragraph in the Petition for Review and redetermination filed by the petitioners with the Tax Court was admitted by the respondent in his answer to said Petition.

(Trans. of Record, page 25).

Even the Court recognizing the ambiguity of the words "picked up" recognized that the admission contained by the answer of respondent to petitioners' Petition and the Stipulation of said facts appears to be an admission by the respondent.

(See: Trans. of Record, page 66).

The very nature of the admission by the respondent, both in the pleading stipulation and in the evidentiary stage found in the Stipulation of Facts, would seem to finally dispose of the respondent's position without

anything else before the Court that the income should have been reported by anyone other than Mills Winery, a California corporation which did report said income.

This is especially pertinent since the respondent had the burden of proof before the Tax Court.

Therefore, it is respectfully submitted that based upon the very admissions of the respondent and upon the uncontradicted testimony of Kershaw, the findings of the Court are not supported by any evidence and that the decision of the Court is strained, illogical and apparently, nothing more than the attempt by the trial Court to reconstruct evidence to support the burden of the respondent which under the law and the rules of evidence cannot be done.

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#### IV.

**THE THREE YEAR STATUTE OF LIMITATIONS ON ASSESSMENTS AND COLLECTIONS BAR THE ASSESSMENT OF THE DEFICIENCY AS DETERMINED BY THE RESPONDENT AGAINST THESE PETITIONERS. THE RESPONDENT HAS NOT SUSTAINED THE BURDEN OF PROOF IN PROVING ANY ALLEGED OMISSION FROM THE GROSS INCOME OF THE PETITIONERS.**

The petitioners filed their income tax returns for the taxable year 1946 in 1947. Under Sec. 275(a) Internal Revenue Code the notices of deficiency would have to have been mailed in March 1950. The deficiency notices however were not mailed until May, 1953. Thus, more than three years expired after the returns were filed. By reason of the lapse of time,

the burden of proof is on the respondent to prove that the petitioners have understated their gross income and the amount includable therein was in excess of Twenty-Five Per Cent (25%) of the amount of the gross income stated in the return in order to take advantage of the extension of the statute of limitations to five years.

*Jacobs v. United States*, 126 Fed. Supp. 154 at 159 where the Court held:

“For the year ending October 31, 1944, a different rule must apply. When the Commissioner of Internal Revenue made his assessment for that year the normal three year statute of limitations had already expired and the Commissioner was relying on the five year statute of limitations applicable in cases where the taxpayer has understated his income by more than 25% of the amount of his return. To avail himself of this longer limitation period the Commissioner must assume the burden of proving that the taxpayer has understated his income by more than 25% . . . since the government has not sustained its burden or proof the three year statute of limitations precluded a lawful assessment of that year.”

It is submitted that from the evidence that has been introduced and from the stipulations that were made and filed with this Court, the respondent has not sustained his burden of proof that the petitioners have understated income properly includable in their income by more than 25% of the income reported in their returns. To the contrary, the case seems to have



been more the result of a fishing expedition by the respondent than proof of sufficient weight and preponderance to put into effect the five-year statute of limitations. Therefore, since the respondent has not sustained his burden of proof, the three-year statute of limitations has precluded a lawful assessment against the petitioners for the year 1946.

In passing, it should likewise be noted that the five-year period which would go into effect if the respondent has sustained his burden of proof, as required to bring this section into play, would have expired in March of 1952. In order to take advantage of a period in excess of the five-year period the respondent has offered into evidence waivers signed by the petitioners prior to the expiration of the five-year period, that is, prior to March, 1952. The petitioners herein respectfully submit that the waivers that were executed after the three-year period expired were ineffective. The waivers were filed in January and in February, 1952, approximately five years to the month from the return date of the petitioners' 1946 Income Tax Returns.

*Kohlhase v. Commissioner of Internal Revenue*,  
181 Fed. 2nd 331;

*Commissioner of Internal Revenue v. Oswego & Syracuse Railway Co.*, 62 Fed. 2nd 518.

Recently however the Tax Courts of the United States have been confronted with a problem somewhat similar to the case now before this Court in connection with consents extending the period of limitation. It has been held that where consents extending the



period of limitation were executed more than three years but less than five years after the return due dates, the timeliness of the deficiency notice depended on whether or not the five-year statute of limitations was applicable.

*Ray Gasper*, June 30, 1953 (T.C. Memo. Op. Dkt. 32252).

However, it is respectfully submitted that this rule in the *Ray Gasper* case (supra) requires reexamination. To permit the execution of consents after the expiration of the normal three-year statute of limitations, but before the expiration of the five-year statute of limitations that may come into play because of an alleged under-statement of income would subject the taxpayer to the unnecessary vicissitudes of a trial which is contrary to the purpose of the statute of limitations. If the Court finds that the five-year statute of limitations does not apply, then the consents executed after the three-year statute would be invalid. This seems to be a somewhat illogical rule and contrary to the general rule on limitations of actions and waiver thereof. There is nothing wrong to compel the agents of the Internal Revenue Department to obtain consents prior to the expiration of the normal period of the statute of limitations in order to assist the government in their investigations and administration towards the collection of taxes. The extension of this rule as was enunciated in the *Ray Gasper* case (supra) is contrary to the general purposes of a statute of limitations and contrary to cases that were decided previously. Thus, the rule

should be as it has been and that is, consents to be effective must be executed prior to the expiration of the three-year statute of limitations.

*Charles E. Sorensen v. Commissioner of Internal Revenue*, May 1954, 22 T.C. 321.

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### CONCLUSION.

It is therefore respectfully submitted that the decision of the Tax Court entered May 7, 1956, wherein said Court affirmed the determination of the respondent that petitioners were indebted as a result of personal income tax liability was in error and that the decision of said Court be reversed and that a judgment be entered by this Honorable Court determining that the net income arising from the sale of wine from March through June, 1946, was income belonging to Mills Winery, a California Corporation, which said income was properly includable in the income reported by said corporation to the U. S. Government.

Dated, Oakland, California,

February 11, 1957.

ROBERT C. BURNSTEIN,

*Attorney for Petitioners.*



No. 15270

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In the United States Court of Appeals  
for the Ninth Circuit

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ROBERT AZEVEDO, IRENE KERSHAW AND PAUL KERSHAW,  
JR., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

---

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE  
TAX COURT OF THE UNITED STATES

---

BRIEF FOR THE RESPONDENT

---

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FILED

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**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 15270

ROBERT AZEVEDO, IRENE KERSHAW AND PAUL KERSHAW,  
JR., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

---

*ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE  
TAX COURT OF THE UNITED STATES*

---

**BRIEF FOR THE RESPONDENT**

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**OPINION BELOW**

The memorandum findings of fact and opinion of the Tax Court (R. 45-77) are not officially reported.

**JURISDICTION**

This review involves federal income taxes for the tax year 1946. (R. 3, 26.) On May 13, 1953, the Commissioner of Internal Revenue mailed the taxpayers notices of deficiencies in the total amount of \$118,071.22, attributable to Robert Azevedo for \$65,020.05, Paul Kershaw, Jr., for \$25,943.07, and Irene Kershaw for \$27,108.10. (R. 13, 45, 62.) Within ninety days thereafter and on August 3, 1953, the taxpayers filed peti-

tions with the Tax Court for redetermination of the deficiencies under the provisions of Section 272(a) of the Internal Revenue Code of 1939. (R. 3, 22.) The decisions of the Tax Court were entered May 7, 1956. (R. 77-79.) Petitions for review by this Court were filed June 25, 1956. (R. 80-85.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

#### QUESTION PRESENTED

Whether the income from sales of wine during the months from March through June, 1946, is taxable to Robert Azevedo and Paul Kershaw, Jr., as the Tax Court held, or whether the income is taxable to the corporation, Mills Winery, Inc.

#### STATUTES INVOLVED

The pertinent provision of the statutes involved are set forth in the Appendix, *infra*.

#### STATEMENT

This appeal involves Robert Azevedo and Paul Kershaw, Jr. Irene Kershaw, Paul Kershaw's wife, is a party only because of the tax effect of California's community property law. (R. 46.)

Robert's father, John Azevedo, was engaged in the construction contracting business in 1945, and also owned a winery near Sacramento, consisting of realty and five buildings, known as Mills Winery. The adjusted basis of the winery property to John Azevedo was \$100,000 in 1945. Before July, 1945, John Azevedo did not have the permits required to make and sell wine, and therefore leased the winery to Christian Brothers Winery. At about the end of June, 1945, the lease of

the winery terminated and in July, 1945, the necessary basic permits to make and sell wine and distilled spirits were issued John Azevedo by the Federal Alcohol Tax Unit of the Bureau of Internal Revenue and the California State Board of Equalization. John then commenced operations as a sole proprietor doing business under the name of Mills Winery. (R. 46-47.) In July, 1945, he employed Paul Kershaw, a salesman, to take care of sales, and employed Robert as the wine maker. (R. 33-34.)

In the fall of 1945, John borrowed \$440,000 from the Capital National Bank of Sacramento for the purpose of buying grapes for the making of wine and he gave his note to the bank for the loan. Also, a checking account was established in Capital National Bank for the operation of Mills Winery. John Azevedo was the only person authorized to sign checks on and withdraw funds from this account during 1945 and until about August 1, 1946. (R. 47.)

In about August, 1945, John made an oral agreement with Robert and Kershaw to sell them the winery at "adjusted cost." (R. 34.) On or about December 1, 1945, after the fall crush but before the sale of any of the wine, the oral agreement was reduced to writing. (R. 34, 48.) The written contract reads in material part as follows (R. 20-21):

1. It is mutually understood and agreed by and between the parties that seller will sell to purchasers that certain winery known as Mills Winery, located at Mills Junction, California, together with all the assets pertaining thereto for the adjusted cost of said winery, plus all other of said winery, including inventory at cost price.



2. Purchasers agree to purchase said winery hereinbefore mentioned under the terms and conditions stated in paragraph 1, above.

3. It is mutually understood and agreed that seller shall remain the owner of said property until such time as the purchasers shall be permitted to receive in their name certain basic permits which will enable them to purchase and own said winery and operate the same; provided, however, that purchasers shall, on January 1, 1946, operate and manage said winery for seller until said time as purchasers shall be able to make actual purchase of said winery, provided further that the compensation for said management, purchasers shall receive as salary the earnings of said business during said period of management.

4. It is further mutually agreed and understood by the parties hereto that unless the above mentioned permits are issued in the names of purchasers on or before January 1, 1947, this agreement shall at the option of seller be declared null and void.

5. It is hereby understood and agreed by the parties hereto that this agreement shall apply not only to the parties hereto but to their assigns.

In Witness Whereof, the parties hereto have hereunto set their hands the day and year first above written.

Signed—John Azevedo  
Robert Azevedo  
Paul Kershaw, Jr.

Commencing in August, 1945, Kershaw bought grapes for the fall 1945 crush. Robert performed the services of winemaker. John, although engaged in the contracting business, was present at the winery to supervise some construction work, and he also attended to financial transactions with Capital National Bank. The cost of the construction work was \$10,000. By December 1, 1945, the fall crush was completed and an inventory of wine was in process of manufacture. No wine was sold during 1945. All of the wine produced from the 1945 crush was sold during four months in 1946, namely, March, April, May, and June. (R. 47-48.) The sales were bulk sales in large quantities to Italian Swiss Colony Wine Company, Petri Wine Company, and Christian Brothers Wine Company. The invoices for the sales bore the name, "Mills Winery." (R. 42, 52.)

The Commissioner determined, and the taxpayers concede, that the net profit derived from the sale was \$202,113.82. The Capital National Bank was repaid the loan made to John, \$440,000, out of the proceeds from the sales. (R. 51, 52.)

Robert and Kershaw paid John \$110,000 in installments during March, April, June, and July. The payments were made out of the proceeds of the sales of wine. The sum of \$110,000 represented John's adjusted basis of the Mills Winery property plus \$10,000 for improvements, which was the consideration stated in the purchase and sale agreement dated December 1, 1945. On July 4, 1946, when the last installment was paid John, he was still on the premises of Mills Winery. (R. 51-52.)

On March 4, 1946, Robert and Kershaw filed with the Secretary of State of California articles of incorpora-

tion of a corporation named "Mills Winery, Inc," to be engaged in producing and selling wine and distilled spirits. (R. 33, 52, 132.) The directors held their first meeting on March 20, 1946. | At this meeting by-laws were adopted, Robert was elected president of the corporation, and Kershaw was elected vice-president, secretary, and treasurer. | (R. 52.)

At a meeting of the directors on August 12, 1946, a resolution was adopted authorizing the issuance of 20,000 shares of capital stock of the par value of \$100 per share, 10,000 shares each to be issued Robert and Kershaw. (R. 52-53.) Application for such stock issue was filed with the California Corporation Commissioner on September 18, 1946. (R. 54.) The application was granted on October 2, 1946, subject to the restriction that the stock be placed in escrow. Thereafter the corporation issued 10,000 shares each in the names of Robert and Kershaw but the stock was immediately placed in escrow with their attorney of record in this case, Robert C. Burnstein. At the time of the trial of these cases, all of the stock was still held by Burnstein in escrow. The escrow requirement was in accordance with the laws of California. (R. 56-57.)

On May 1, 1946, Treasury Form 698 had been executed on behalf of John Azevedo, doing business as "Mills Winery," and filed with the Federal Alcohol Tax Unit. In the Form 698 John Azevedo advised the Alcohol Tax Unit that he intended his basic permits to conduct a winery for the manufacture of wine and the distilling of spirits to be discontinued as of the date similar basic permits and licenses were issued to "Mills Winery Inc." (R. 37, 55.)

On May 3, 1946, the corporation Mills Winery, Inc.,

made application to the federal authorities for basic permits to produce, blend, distill, and sell wine and spirits. Attached to the application was the following sworn statement (R. 37, 55):

Applicant's place of business will be purchased from John Azevedo, an individual and the present owner, when proper permits are received by applicant to engage in the operations of a Fruit Distillery.

A wine producer's and blender's basic permit and a distiller's basic permit were issued by the Alcohol Tax Unit of the Bureau of Internal Revenue under date of August 13, 1946, effective August 7, 1946. On about August 12, 1946, but before that date, the California State Board of Equalization issued to Mills Winery, Inc., a wine manufacturers' license and a distilled spirits manufacturers' license. (R. 55-56.)

By a grant deed dated June 21, 1946, John Azevedo and Frances Azevedo, as grantors, granted to Mills Winery, Inc., all the real property upon which the Mills Winery premises and equipment were located. The deed was held in escrow. The escrow instructions do not contain information regarding the delivery of the deed nor the length of time it was to be held in escrow, nor does the record establish when it was delivered to Mills Winery, Inc. The deed was recorded with the Recorder of Sacramento County on November 23, 1946. (R. 56.)

After the organization of Mills Winery, Inc., on March 4, 1946, various activities were carried on by Robert and Kershaw as officers and directors. All of these activities, such as contracting with certain individuals concerning the distilling of spirits during the

fall, 1946 season, and entering into written contracts with the Southern Pacific Company, were transacted by Robert and Kershaw on behalf of and in their capacity as officers of Mills Winery, Inc. (R. 38-39, 57-58.)

Certain improvements and alterations on the winery premises were made from June through August, 1946, which were paid for by the corporation. (R. 58.)

The corporation did not file application Form SS-4 for an Employer's Identification Number until August 8, 1946, and the notifications of change in ownership of insurance policies and motor vehicles were not made by the corporation until August, 1946, or subsequently. (R. 58.)

At all times material there was a single checking account in the Capital National Bank of Sacramento, California, for the business operations of Mills Winery. During the period of August 1, 1945, to August 1, 1946, John Azevedo had the sole authority to sign checks and withdraw funds from this account. On and after August 1, 1946, Robert and Kershaw were granted permission to withdraw funds from the bank account on behalf of the corporation. (R. 59.)

It was stipulated that Robert and Kershaw had prepared for filing with the Bureau of Internal Revenue a partnership income tax return for the period August 1, 1945, to March 1, 1946, which reflected a closing inventory on the latter date of \$445,467.09. (R. 34-35.) However, the records of the Commissioner of Internal Revenue do not show that a partnership return was filed for any period or for the period August 1, 1945, to March 1, 1946 (R. 59), and no proof was offered that such a return was ever filed (see R. 93-95). The



prepared return appears not to have been signed. (Ex. 3-C.)

A financial statement stated that a partnership of Robert and Kershaw had an inventory as of March 3, 1946, of \$445,467.09. (R. 35.) This statement was prepared by the accountants "without audit." (R. 36.) Nowhere did the Commissioner concede the truth of the facts set out in the financial statement. The Commissioner merely stipulated that the statement existed. (R. 35.)

A corporation income tax return, and an amended corporation return was filed for Mills Winery, Inc., for the taxable period March 4, 1946, to March 3, 1947, which returns reflect the net income from the sales of wine here in question. These returns state the opening inventory to be \$445,467.09. (R. 60-61.)

The Commissioner admits that corporate books were opened for Mills Winery, Inc., as of March 4, 1946, and that all sales of wine made during the period March 4, 1946, to August 6, 1946, were "picked up" as corporate gross profit when the corporate returns were filed. (R. 25, 42-43, 164.) Taxpayer conceded that the expression "picked up" meant merely that the sales were reported on the books and returns as corporate gross income. (R. 164.) Nowhere did the Commissioner concede that the income from the sales was the income of the corporation.

In the minutes of a special meeting of the directors of Mills Winery, Inc., on August 12, 1946, a resolution was adopted which provided that Robert and Kershaw were to pay to the corporation in cash \$55,000, each, or \$110,000 for the purpose of obtaining the deed from John and Frances Azevedo to the real property where

the Mills Winery is located. The sum of \$110,000 was never paid to the corporation by Robert and Kershaw. A liability of \$110,000 owed by them was first reflected on the balance sheet of the corporation return filed for the period of March 1, 1951, to February 29, 1952. (R. 61.)

On October 17, 1946, Robert sold all of his stock in Mills Winery, Inc., to Paul Kershaw for \$50,000. (R. 62.) The loss on this sale was recognized by the Commissioner for tax purposes. (R. 65.)

The individual returns for 1946 of Robert Azevedo, Paul Kershaw, Jr., and Irene Kershaw were filed on March 7, 1947, March 15, 1947, and March 20, 1947, respectively. (R. 62.) These returns did not reflect any of the \$202,113.82 of net profit from the sales of wines from the 1945 crush. (R. 64-65.)

Consents were executed by Robert Azevedo on February 26, 1952, and by Paul Kershaw, Jr., and Irene Kershaw on January 22, 1952, extending to June 30, 1953, the time within which the income tax for the year 1946 might be assessed. (R. 62.) The notices of deficiencies which have given rise to these cases were mailed by the Commissioner on May 13, 1953. (R. 62.)

The Tax Court found that title to the winery did not pass to Mills Winery, Inc., until sometime after August 12, 1946, and that John Azevedo did not sell the wine inventory from the 1945 crush to Robert and Kershaw or to the corporation before the wine was sold. (R. 62.)

The Tax Court held that of the \$202,113.82 earned from the sale of the 1945 crush, 50 per cent or \$101,056.91 was attributable each to Robert Azevedo and Paul Kershaw as compensation and salary for their services in the operation and management of Mills

Winery, and for their services in making and selling the wine from the 1945 crush during the period January 1, 1946, to August 6, 1946. The Tax Court held that these net earnings were not the earnings of the corporation, Mills Winery, Inc. (R. 63.)

The Tax Court found that since the income in question was taxable to taxpayers, each taxpayer had omitted from his and her gross income an amount properly includable therein which is in excess of 25 per cent of the amount of gross income stated in the individual returns, and therefore held that the notices of deficiencies, having been mailed before the date specified in the consents extending the period of limitations, were timely and the deficiencies were not barred by the statute of limitations. (R. 63-64, 76-77.)

#### SUMMARY OF ARGUMENT

### I

Income earned from the sale of goods or property is taxable to the person who owned the property at the time the income was produced. At the time of the sales of the wine from the 1945 crush, and at all times before, the wine was owned by John Azevedo. At no time was the wine owned by Mills Winery, Inc. Therefore, the income was not attributable or taxable to Mills Winery, Inc.

By the terms of the December 1, 1945, contract the taxpayers were to continue in their capacity as managing employees of the winery, which, along with the inventory of wine, was to remain the property of their employer John Azevedo until basic permits were issued authorizing the taxpayers to engage in the production and sale of wine. For their services they were to re-

ceive "compensation" and "salaries" measured by the net profits from the winery. Their status as employees of John Azevedo did not change until the basic permits were issued, effective as of August 7, 1946. The net earnings of the business to that date were, by the terms of the contract, taxable fifty per cent each to Robert and to Kershaw individually as compensation and salary for their services in managing and operating John Azevedo's winery.

Until new basic permits were issued it would have been illegal for either the taxpayers or their corporation to produce, distill, or sell at wholesale any wine or spirits. It was to avoid any possible infraction of the law that the ownership of the winery and the wine remained in John Azevedo until the proper permits were issued. Thus in applying for its permits, the corporation was careful to point out that it had not yet acquired the winery and would not do so until the permits were issued. Their basic purpose to stay within the law is entirely inconsistent with the contention that the corporation owned and sold the wine.

The Tax Court's holdings that the wine was at all times the property of John Azevedo, and that the income from the sales was taxable to Robert and to Kershaw individually as compensation and salaries, are not at all in conflict with the stipulation of facts. The Tax Court gave careful attention to all the evidence including the stipulation of facts. That the taxpayers' entire case apparently rests on the contention that the Commissioner stipulated himself out of court, demonstrates the weakness of their case.

## II

Under Section 275(c) of the Internal Revenue Code of 1939, the period of limitations for an assessment of a deficiency is five years if the taxpayer has omitted from gross income more than twenty-five per cent of the amount stated in the return which is properly includable therein. Taxpayers having failed to report the income in question, the five-year statute of limitations was applicable. Consents extending the time to June 30, 1953, within which the 1946 deficiencies could be assessed, were executed by the taxpayers before the five-year period had expired. Therefore, under Section 276(b) of the Internal Revenue Code of 1939, the deficiency notices, which were mailed on May 13, 1953, were timely.

## ARGUMENT

## I

**The Income From the Sales of Wine During the Months From March Through June, 1946, Is Taxable Individually to Robert Azevedo and Paul Kershaw, Jr., as Compensation and Salary**

The issue in this case is whether the net income from the sales of wine from March through June, 1946, is taxable to the taxpayers as the Tax Court held, or was earned by Mills Winery, Inc. It is basic to income tax law that income is taxed to him who earns it. *Lucas v. Earl*, 281 U.S. 111; *Helvering v. Eubank*, 311 U.S. 122; *Strauss v. Commissioner*, 168 F. 2d 441 (C.A. 2d), certiorari denied, 335 U.S. 858. Income earned from property, or produced by the sale of goods or property, is taxable to the person who owned the property at the time the income was produced. *Corliss v. Bowers*, 281 U.S. 376; *Blair v. Commissioner*, 300 U.S. 5; *Helvering*



v. *Horst*, 311 U.S. 112; *Harrison v. Schaffner*, 312 U.S. 579; *Commissioner v. Reece*, 233 F. 2d 30 (C.A. 1st). Taxpayers' theory is that the wine was owned by the corporation during the period of the sales, and is thus taxable to it. The Commissioner's position is that the wine was at all times owned by John Azevedo, and that the taxpayers received salaries or compensation taxable to them individually under Section 22(a) of the Internal Revenue Code of 1939. (Appendix, *infra*.)

In July, 1945, John Azevedo *employed* Kershaw to manage sales of wine, and *employed* his son Robert as a wine maker. (R. 33-34.) In August, 1945, John orally agreed to sell Robert and Kershaw the winery. This agreement was reduced to writing on December 1, 1945, before the sale of any wine from the 1945 crush. (R. 34, 48.) By the terms of this written contract John Azevedo was to sell, and Robert and Kershaw to purchase, Mills Winery at John's adjusted cost, plus all other appurtenances "including inventory at cost." (R. 20.) It was expressly specified (R. 20-21) that John Azevedo was to remain the owner—

until such time as the purchasers shall be permitted to receive in their name certain basic permits \* \* \*

and furthermore (R. 21) that the

purchasers shall, on January 1, 1946, operate and manage said winery for seller until said time as purchasers shall be able to make actual purchase of said winery, provided further that the *compensation for said management*, purchasers shall receive *as salary* the earnings of said business during said period of management. (Italics supplied)

It is seen that by the terms of the written contract Robert and Kershaw were to continue in their capacity as employees of John Azevedo, and John was to retain title to the winery, which included the inventory, until the purchasers received the basic permits authorizing them to engage in the production and sale of wine and distilled spirits.

The objective of the parties is immediately apparent. The purchasers were legally disabled from engaging in producing, distilling, or purchasing for resale at wholesale, wines and spirits without obtaining the necessary basic permits from the Federal Government and from the State of California. See Section 3 of the Federal Alcohol Administration Act (Appendix, *infra*). Until the basic permits were issued to Mills Winery, Inc., on August 13, 1946, the taxpayers assiduously avoided any action which might be construed as a violation of the law. And John Azevedo carefully preserved his basic permits until the corporation acquired permits of its own. Thus John Azevedo, in advising the Alcohol Tax Unit of his intention to give up his permits, expressly postponed the date of expiration of such permits until similar basic permits were issued to Mills Winery, Inc. (R. 37, 55.) Similarly, in applying for its permits, the corporation was careful to point out that it had not yet acquired the winery and would not do so until the permits were issued authorizing it to engage in operations. (R. 37, 55.)

The parties certainly acted carefully, and properly, in avoiding a violation of the law. But this very fact is entirely inconsistent with the contention of the taxpayers that the corporation owned and sold the wine. It was impossible for the corporation to have legally

owned and sold the wine until issuance of the basic permits. Section 3 of the Federal Alcohol Administration Act (Appendix, *infra*). And the permits were not issued until after the wine had been sold.

Furthermore, the checking account was established for the operation of Mills Winery, the sole proprietorship of John Azevedo. (R. 47.) This was the only account drawn on for the business operations here in question, and John Azevedo had the sole authority to sign checks and withdraw funds from this account. Not until August, 1946, when the basic permits were issued Mills Winery, Inc.,—and after the wine in question had been sold—did either of the taxpayers have permission to withdraw funds from the bank account on behalf of the corporation. (R. 55-56, 59.)

And the loan of \$440,000, used to purchase the grapes for the 1945 crush, was taken out by John Azevedo. (R. 47.) Since he alone was liable on the note to the Capital National Bank (R. 47), the repayment of this loan from the proceeds of the sales of the wine also shows that John Azevedo, as the proprietor of Mills Winery, was the owner and vendor of the wine. This is completely consistent with the written contract of December 1, 1945.

There is yet further evidence that the wine was owned and sold by John Azevedo. The wine produced from the 1945 crush was sold wholesale to Italian Swiss Colony Wine Company, Petri Wine Company, and Christian Brothers Wine Company. The invoices for the sales bore the name "Mills Winery", and not "Mills Winery, Inc." (R. 42, 52.) This is especially significant since, as we are willing to concede, after March 4, 1946, the corporation Mills Winery, Inc., transacted several matters in all of which it was specifically de-

scribed as a corporation. Thus the written contract executed by Kershaw on April 9, 1946, with certain other persons in connection with the fruit season of 1946, described the party of the first part as "Mills Winery, a California Corporation." (Ex. 6-F; R. 38.) And the written contracts entered into with the Southern Pacific Company on May 11 and 23, 1946, described the party of the second part as "Mills Winery, Incorporated" and were signed by Robert Azevedo as President of "Mills Winery, Incorporated." (R. 38-39; see Exs. D and E attached to Pets. to the Tax Court.)

It is apparent that in all matters where the taxpayers intended the corporation to be a party, the evidence of the transaction accurately described the participating party as a corporation. It is clearly no mere oversight, therefore, that the invoices for the sales in question state that the sales were made by "Mills Winery", John Azevedo's business, and not by the corporation. This factor is emphasized by the fact that the taxpayers did not offer in evidence the checks from the vendees on the sales of approximately \$700,000. (R. 51.) We must assume that the payee was "Mills Winery," and not "Mills Winery, Inc.," particularly since the only bank account in existence was that of the sole proprietorship.

It should be noted that the question is not, as taxpayers conceive it (Br. 21), whether the corporation was a sham. We readily concede that the corporation was *bona fide*. The question is merely whether it owned and sold the wine from the 1945 crush. The answer is that even though it was organized as of March 4, 1946, and even though it transacted certain matters which did not require permits, it was legally unable to engage in the claimed activities, namely, buying and re-



selling the wine. And all of the evidence shows that in arranging the sale, in applying for the basic permits, and in all other matters relating to the production and sale of wine, the taxpayers adhered strictly to the letter of the law, which forbade these sales except by a person possessing the basic permits.<sup>1</sup> It was for that reason that the contract of December 1, 1945, specifically retained title in John Azevedo to the winery and the inventory of wine until the taxpayers or the corporation obtained the basic permits.

As further proof that the corporation did not engage in producing and selling wine until after the permits were issued is the fact that the notifications of change in ownership of the winery insurance policies and motor vehicles were not made until August, 1946, or thereafter. (R. 58.)

At about the time when all of the wine had been sold,

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<sup>1</sup> Section 3(c) of the Federal Alcohol Administration Act (Appendix, *infra*). Taxpayers' statement (Br. 19) that the corporation would not have required a permit for the sales in question is obviously incorrect. To begin with, the wine was not disposed of in one isolated sale so as to warrant a claim that the vendor was not engaged in the business. The wine was disposed of through many sales over a four-month period to three large wine companies, Italian Swiss Colony, Petri, and Christian Brothers. (R. 42.) *Supreme Malt Products Co. v. United States*, 153 F. 2d 5 (C.A. 1st), which involved one isolated sale, is, therefore, clearly distinguishable.

In any event the corporation was organized to distill, produce, and sell wine. After issuance of the basic permits in August, 1946, it commenced such operations. If it had bought and sold the wine in question, the sales would have been in such close proximity and so related to the activities conducted after August that it could not reasonably be argued that the disposition of the wine in question constituted an isolated transaction having no connection with the corporation's regular business activities. Therefore, had the corporation in fact bought and sold the wine, it would have been in violation of law, the very thing taxpayers were so alert to avoid.



and on June 21, 1946, John Azevedo and his wife executed a deed to the real property and equipment of the winery to the corporation. But the deed was not immediately delivered, it being held in escrow for a period of time. The record does not show when the deed was delivered, but it is reasonable to assume that the date of delivery may have been around November 23, 1946, when it was recorded. (R. 56.) So far as the record indicates, there was no transfer of ownership until sometime after the basic permits were issued the corporation, and such fact is completely consistent with the intent of the parties as expressed in the December 1, 1945, contract.

Taxpayers state that from August 1, 1945, they operated as a partnership, each partner being entitled to fifty per cent of the profits. But the clear terms of the December 1, 1945, contract state that they were to operate and manage the winery for John Azevedo until they were issued the basic permits, and that they should receive the earnings of the business as "salary" and "compensation" for their services. (R. 21.) The fact that their salaries or compensation were to be measured by the earnings of the business cannot be taken to show that they owned either the winery or the wine. The claim that, where a taxpayer receives the profits of an operation, he must be the owner of the business property was rejected by this Court in *Carlen v. Commissioner*, 220 F. 2d 338, where it appeared, as here, that the parties intended the profit as a measure of the value of the taxpayers' services.

The parties entered into the December 1, 1945, contract as representing their intention that title to the wine and winery was to remain with John Azevedo

until permits were issued the taxpayers. This fact was confirmed on May 3, 1946, in the application for permits made by the corporation. (R. 37, 55.) There is nothing in the record to indicate that the December 1 contract was ever modified. Nevertheless the taxpayers are here attempting to impeach the clear and unambiguous terms of the contract. To allow a party to such a contract to later state for tax purposes, without any convincing evidence that the terms were later modified, that his own contract does not mean what it says, would place a very heavy and unjust burden on the Internal Revenue Service. *Maletis v. United States*, 200 F. 2d 97, 98 (C.A. 9th) ; *Higgins v. Smith*, 308 U.S. 473, 477. Compare *Hatch's Estate v. Commissioner*, 198 F. 2d 26 (C.A. 9th).

The Tax Court's conclusions are not at all in conflict with the stipulation of facts. The two are easily reconcilable. For example, taxpayers point to the stipulated fact that the corporation filed a return for the fiscal year ending March 3, 1947, on which return it was stated that the inventory as of March 4, 1946, was \$445,467.09, presumably the cost of the wine inventory. (R. 34-35.) Taxpayers' conclusion is that this is a concession by the Commissioner that the corporation owned the wine. (Br. 34.) But the Commissioner only admitted that the return was filed ; he did not concede the truth of the assertions therein. Obviously if the Commissioner were bound by a taxpayer's return, a tax deficiency could never be assessed. The Tax Court was perfectly correct in stating that (R. 72) :

The mere statement in the corporation income tax return \* \* \* that the corporation had an inventory

in the amount of \$445,467.09 on March 4, 1946, is not competent proof that the corporation in fact acquired and owned the inventory of wine \* \* \*. Such statement in the original and amended corporation returns is self-serving.

The same may be said of taxpayers' contention that the financial statement prepared for Robert and Kershaw as of March 3, 1946, proves that as of that date they owned the wine. Taxpayers' assumption (Br. 35) is that the Commissioner stipulated to the truth of the financial statement. This is not so. Paragraph 6 of the stipulation (R. 35-36) merely says that the financial statement was prepared and that it stated the inventory to be \$445,467.09. The statement was completely self-serving, and we might add, stated on its face that it was prepared "without audit." (R. 36.) There is nothing in the stipulation contrary to the Tax Court's finding (R. 72, 73) that Robert and Kershaw never owned the wine and therefore could not have conveyed it to the corporation.

Similarly the Commissioner has not stipulated in paragraph 23 of the stipulation (R. 42-43) that the income from the sales belonged to the corporation, as taxpayers assert (Br. 37-38). True, the Commissioner admitted that the income was "picked up" on the corporate books. But "picked up" means merely that the sales were reported on the corporate books and returns as corporate income, as taxpayers concede. (R. 164.) It is a far different matter to say that the income was "picked up" on the corporate records, which is self-serving, than to say that the Commissioner concedes

the truth and accuracy of the records, which he did not do.<sup>2</sup>

Taxpayers state (Br. 38) that paragraph (p) of their petitions to the Tax Court (R. 12), which asserts that the income belonged to the corporation, was admitted in paragraph (p) of the Commissioner's answer (R. 25). This is absolutely incorrect. The answer admitted only that the matters relating to the sales were picked up on the corporate books. That part of the allegation which claims the income belonged to the corporation was denied in paragraph (p) of the answer.

It will be observed that taxpayers' entire case apparently rests on the contention that the Commissioner has conceded, contrary to his deficiency notices (R. 15-19), that the corporation earned the income in question, and thus has stipulated himself out of court. Taxpayers' resort to such a meritless claim demonstrates the weakness of their case.

It is immaterial whether as between themselves Robert and Kershaw performed their duties under the December 1, 1945, contract as though they were partners. Stipulation 4 (R. 34) is not inconsistent with the Tax Court's holding, for under the terms of the contract they remained managing employees of John Azevedo irrespective of their relationship to each other. Their status as employees was not changed until the winery was conveyed to the corporation after the new permits were issued in August, 1946. In this respect it should

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<sup>2</sup> It is axiomatic that corporate books and records are not determinative of tax liability. As the Supreme Court stated in *Bazley v. Commissioner*, 331 U.S. 737, 741: "But the form of a transaction as reflected by correct corporate accounting opens questions as to the proper application of a taxing statute; it does not close them."



be noted that stipulation 4 states that Robert and Kershaw had a partnership return for the period August 1, 1945, to March 1, 1946, *prepared for filing*. However, the records of the Internal Revenue Service showed that the return was never filed (R. 59), and no proof was offered by the taxpayers that such a return was ever filed (R. 93-95). For that matter, the prepared return appears not to have been signed. (Ex. 3-C.)

The Tax Court was correct in holding (R. 74) that the corporation never owned the wine and that the income from the sales, therefore, was not the income of the corporation. *Helvering v. Horst*, 311 U.S. 112; *Blair v. Commissioner*, 300 U.S. 5; *Corliss v. Bowers*, 281 U.S. 376. The Tax Court was correct in holding (R. 63) that the earnings from the sales of wine represented compensation and salary to Robert and Kershaw for their services in the operation and management of John Azevedo's winery. Such income is necessarily taxable to each individually. Section 22(a) of the 1939 Code (Appendix, *infra*); *Lucas v. Earl*, 281 U.S. 111; *Helvering v. Eubank*, 311 U.S. 122.

## II

### **The Assessment of Deficiencies for 1946 Was Not Barred by Section 275 of the Code**

The income tax returns for 1946 for Robert Azevedo, Paul Kershaw, Jr., and Irene Kershaw were filed on March 7, 1947, March 15, 1947, and March 20, 1947, respectively. (R. 62.) Under Section 275(a) of the Internal Revenue Code of 1939 (Appendix, *infra*) the notices of deficiencies would have to have been mailed in March, 1950. But Section 275(a) states only the general rule that income taxes shall be assessed within three



years after the return was filed. An exception is provided by Section 275(c) of the 1939 Code (Appendix, *infra*), which states that the tax may be assessed at any time within *five* years after the return was filed—

If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, \* \* \*.

Section 276(b) of the 1939 Code (Appendix, *infra*) provides as follows:

Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. \* \* \*

If as the Tax Court held the income in question was taxable to taxpayers, then it follows as a matter of arithmetic that they understated their income by <sup>more than</sup> 25 per cent. And it follows as a matter of law that (1) the five-year statute of limitations applies; and (2) any consent to an extension of time for assessment executed within that period is valid. *Gasper v. Commissioner*, 225 F. 2d 284, 288-289 (C.A. 6th).

Consents were executed by Robert Azevedo on February 26, 1952, and by Paul Kershaw, Jr., and Irene Kershaw on January 22, 1952, extending to June 30, 1953, the time within which the income tax for the year 1946 might be assessed. (R. 62.) These consents were executed before the expiration of five years from the dates the returns were filed, and thus served to extend

the period during which to issue the deficiency notices to June 30, 1953. The deficiency notices were mailed by the Commissioner on May 13, 1953 (R. 62), and were, therefore, timely.

Taxpayers assert, however (Br. 41-42), that consents extending the period must be executed within the three-year period allowed by Section 275(a). Such a contention flies in the face of the statutory language used in Section 276(b). That section does not limit the efficacy of consents only to those executed before the expiration of the time prescribed in Section 275(a), but rather refers to Section 275 *in toto*. Subsection (c) of Section 275 is as much a statute of limitations as is subsection (a). The purpose of Section 276(b) clearly is to validate any consent extending whichever period of limitations is applicable as long as the consent was executed before the expiration of the applicable period. The cases so hold. *Hatch v. Commissioner*, 14 T.C. 237, reversed on other grounds, 190 F. 2d 254 (C.A. 2d); *Gasper v. Commissioner*, decided June 30, 1953 (1953 P-H T.C. Memorandum Decisions, par. 53,234), reversed on other grounds, 225 F. 2d 284 (C.A. 6th), *Ketcham v. Commissioner*, 2 T.C. 159, 165-166, affirmed 142 F. 2d 996 (C.A. 2d); see *Ewald v. Commissioner*, 141 F. 2d 750, 752 (C.A. 6th). The Tax Court was correct in holding (R. 76-77) that the deficiency notices were timely.

## CONCLUSION

For the reasons above, the decisions of the Tax Court are correct and should be affirmed.

Respectfully submitted,

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MARCH, 1957.

## APPENDIX

Federal Alcohol Administration Act, c. 814, 49 Stat. 977:

## UNLAWFUL BUSINESSES WITHOUT PERMIT

Sec. 3 [As amended by Sec. 1, Act of February 29, 1936, c. 105, 49 Stat. 1152]. In order effectively to regulate interstate and foreign commerce in distilled spirits, wine, and malt beverages, to enforce the twenty-first amendment, and to protect the revenue and enforce the postal laws with respect to distilled spirits, wine, and malt beverages:

\* \* \* \* \*

(b) It shall be unlawful, except pursuant to a basic permit issued under this Act by the Administrator—

(1) to engage in the business of distilling distilled spirits, producing wine, rectifying or blending distilled spirits or wine, or bottling, or warehousing and bottling, distilled spirits; or

(2) for any person so engaged to sell, offer or delivery for sale, contract to sell, or ship, in interstate or foreign commerce, directly or indirectly or through an affiliate, distilled spirits or wine so distilled, produced, rectified, blended, or bottled, or warehoused and bottled.)

This subsection shall take effect sixty days after the date upon which the Administrator first appointed under this Act takes office.

(c) It shall be unlawful, except pursuant to a basic permit issued under this Act by the Administrator—

(1) to engage in the business of purchasing for resale at wholesale distilled spirits, wine, or malt beverages; or

(2) for any person so engaged to receive or to sell, offer or deliver for sale, contract to sell, or ship, in interstate or foreign commerce, directly or indirectly or through an affiliate, distilled spirits, wine, or malt beverages so purchased.

This subsection shall take effect July 1, 1936.

This section shall not apply to any agency of a State or political subdivision thereof or any officer or employee of any such agency, and no such agency or officer or employee shall be required to obtain a basic permit under this Act.

(27 U.S.C. 1952 ed., Sec. 203.)

## Internal Revenue Code of 1939:

### SEC. 22. GROSS INCOME.

(a) *General Definition*.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income:



and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly.

\* \* \* \* \*

(26 U.S.C. 1952 ed., Sec. 22.)

# SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule*.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

\* \* \* \* \*

(c) *Omission From Gross Income*.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

\* \* \* \* \*

(26 U.S.C. 1952 ed., Sec. 275.)

# SEC. 276. SAME—EXCEPTIONS.

\* \* \* \* \*

(b) *Waiver*.—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment

after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

\* \* \* \* \*

(26 U.S.C. 1952 ed., Sec. 276.)

No. 15271

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United States  
Court of Appeals  
for the Ninth Circuit

*See vol. 2984*

OREGON PLYWOOD SALES CORPORATION,  
Appellant,

vs.

SUTHERLIN PLYWOOD CORPORATION and  
NORDIC PLYWOOD, INC., Appellees.

---

Transcript of Record

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Appeal from the United States District Court for the  
District of Oregon

FILED

JAN - 7 1957

PAUL P. O'BRIEN, CLERK



No. 15271

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United States  
Court of Appeals  
for the Ninth Circuit

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OREGON PLYWOOD SALES CORPORATION,  
Appellant,

vs.

SUTHERLIN PLYWOOD CORPORATION and  
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Transcript of Record

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Appeal from the United States District Court for the  
District of Oregon

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## NAMES AND ADDRESSES OF ATTORNEYS

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YERKE,

FREDRIC A. YERKE JR., and  
MARK C. McCLANAHAN,

926 American Bank Building,  
Portland, Oregon,

For Appellees.



In the United States District Court  
for the District of Oregon

No. Civ. 7754

OREGON PLYWOOD SALES CORPORATION,  
a corporation, Plaintiff,

vs.

SUTHERLIN PLYWOOD CORPORATION, a  
corporation, and NORDIC PLYWOOD, INC.,  
a corporation, Defendants.

COMPLAINT

I.

Plaintiff is a corporation incorporated under the laws of the State of New York. Defendants are corporations incorporated under the laws of the State of Oregon. The matter in controversy, exclusive of interest and costs, exceeds \$3000.00.

II.

Plaintiff and defendant Sutherlin Plywood Corporation are parties to a contract whereby plaintiff was and is granted the first right and option to buy, at prices therein provided, 80% of defendant's total output of plywood upon terms and conditions therein set forth.

III.

Defendant Sutherlin Plywood Corporation has breached said contract by failing and refusing to grant plaintiff the first right and option therein provided and referred to above, and defendant has sold its mill to defendant Nordic Plywood, Inc.,

thereby wholly disabling itself from performing its obligations under said contract.

#### IV.

Defendant Sutherlin Plywood Corporation has breached said contract by selling part of its production to third persons at a price lower than the wholesale jobber's market price defined in said contract.

#### V.

Defendant Nordic Plywood, Inc. unlawfully interfered with said contract and induced a breach thereof and agreed and conspired with defendant Sutherlin Plywood Corporation to destroy plaintiff's rights therein.

#### VI.

Plaintiff has demanded that defendant Nordic Plywood, Inc. adhere to and perform said contract, and pursuant thereto has placed orders with defendant Nordic Plywood, Inc. to purchase plywood produced in said mill on the terms and conditions therein set forth. Said defendant has wholly refused and failed to fill said orders or any of them or otherwise to adhere to or perform said contract.

#### VII.

By reason of the matters alleged above, plaintiff has suffered damages in the amount of \$100,000.00, and if said acts continue there will be a multiplicity of suits, and plaintiff will suffer immeasurable and irreparable damage.

Wherefore, plaintiff prays for a Judgment and Decree as follows:

(a) Permanently enjoining defendant Nordic Plywood, Inc. from operating said mill except in compliance with the terms of the contract above referred to.

(b) Awarding plaintiff damages in the amount of \$100,000.00 against defendant Nordic Plywood, Inc. for interfering with said contract and inducing a breach thereof and conspiring and agreeing with defendant Sutherlin Plywood Corporation to destroy plaintiff's rights therein.

(c) Awarding plaintiff damages in the amount of \$100,000.00 against defendant Sutherlin Plywood Corporation for breach of contract.

(d) Awarding plaintiff punitive or exemplary damages against both defendants in the amount of \$50,000.00.

(e) Awarding plaintiff its costs and disbursements herein incurred.

(f) Awarding plaintiff such other and further relief as to the Court may seem equitable and just.

KOERNER, YOUNG, McCOLLOCH  
& DEZENDORF,  
/s/ JAMES C. DEZENDORF,  
/s JAMES H. CLARKE,  
Attorneys for Plaintiff

[Endorsed]: Filed November 4, 1954.



[Title of District Court and Cause.]

ANSWER AND COUNTERCLAIM OF DEFENDANT SUTHERLIN PLYWOOD CORPORATION

First Defense

Defendant Sutherlin Plywood Corporation pleads in abatement as follows:

I.

Plaintiff is and at all times since the institution of this action has been a corporation organized and existing under and by virtue of the laws of the state of New York.

II.

At the time of the commencement of this action and at all times since, plaintiff had not and has not now obtained certificate of authority from the Corporation Commissioner of the state of Oregon to transact business in the state of Oregon.

III.

By reason of plaintiff's failure to obtain such certificate of authority, plaintiff lacks the capacity to maintain any action, suit or proceeding in this court.

Second Defense

Comes now defendant Sutherlin Plywood Corporation, and for its answer to plaintiff's complaint, admits, denies and alleges as follows:

I.

Admits the allegations of Paragraph I.

II.

Answering the allegations of paragraph II, defendant Sutherlin Plywood Corporation admits that plaintiff and defendant Sutherlin Plywood Corporation executed an instrument in which defendant Sutherlin Plywood Corporation purported to grant to plaintiff the right to purchase, at prices therein provided, 80 per cent of the total output of plywood of defendant Sutherlin Plywood Corporation upon terms and conditions therein set forth. Denies each and all the remaining allegations of paragraph II.

III.

Answering the allegations of paragraph III, defendant Sutherlin Plywood Corporation admits that it sold its plywood mill to defendant Nordic Plywood, Inc., and that after said sale defendant Sutherlin Plywood Corporation possessed no facilities for manufacturing plywood. Denies each and all the remaining allegations of paragraph III.

IV.

Denies each and all the allegations of paragraph IV.

V.

Denies each and all the allegations of paragraph V.

VI.

Answering the allegations of paragraph VI, defendant Sutherlin Plywood Corporation admits that plaintiff has demanded that defendant Nordic Plywood, Inc., sell plywood to plaintiff in accord-

ance with the purported grant contained in said instrument, and has placed orders with defendant Nordic Plywood, Inc., to purchase plywood produced in said mill purportedly on the terms and conditions set forth in said instrument, and that defendant Nordic Plywood, Inc., has wholly refused and failed to fill said orders, or any of them, or otherwise to sell plywood to plaintiff in accordance with said purported grant. Denies each and all the remaining allegations of paragraph VI.

## VII.

Denies each and all the allegations of paragraph VII.

### Third Defense

Defendant Sutherlin Plywood Corporation moves the court for an order striking from the prayer of the complaint the following:

“(d) Awarding plaintiff punitive or exemplary damages against both defendants in the amount of \$50,000.00.”

on the ground that the same is wholly irrelevant and not pertinent to the cause of suit undertaken to be alleged in said pleading.

### Fourth Defense

#### I.

On or about December 17, 1953, plaintiff and defendant Sutherlin Plywood Corporation executed a certain instrument, a photostatic copy of which is attached hereto, marked Exhibit A, and by reference made a part hereof. Defendant Sutherlin

Plywood Corporation is informed and believes, and on information and belief alleges, that said instrument is the same as the alleged contract referred to in plaintiff's complaint herein.

## II.

The purported grant by defendant Sutherlin Plywood Corporation to plaintiff of a right to purchase 80 per cent of the total output of defendant Sutherlin Plywood Corporation contained in said instrument was made without consideration.

## Fifth Defense

### I.

The alleged contract referred to in plaintiff's complaint and by which defendant Sutherlin Plywood Corporation is sought to be charged was and is by its terms not to be performed within a year from the making thereof. Neither said alleged contract, nor any note or memorandum thereof, expresses any consideration.

### II.

Said alleged contract is void under the statutes of frauds, ORS 41.580.

## Sixth Defense

### I.

At all times herein mentioned plaintiff was and now is a corporation organized and existing under and by virtue of the laws of the state of New York. At all times herein mentioned Oregon Plywood Cor-

poration was and now is a corporation organized and existing under and by virtue of the laws of the state of Oregon. Defendant Sutherlin Plywood Corporation is informed and believes, and on information and belief alleges, that plaintiff is a subsidiary corporation owned or controlled by Oregon Plywood Corporation.

## II.

At all times herein mentioned defendant Sutherlin Plywood Corporation was and now is a corporation organized and existing under and by virtue of the laws of the state of Oregon.

## III.

On or about December 17, 1953, defendant Sutherlin Plywood Corporation made, executed and delivered its promissory note to Oregon Plywood Corporation for the sum of \$50,000, with interest thereon payable at the rate of 4 per cent per annum from date until paid.

## IV.

On or about December 17, 1953, defendant Sutherlin Plywood Corporation made, executed and delivered to Oregon Plywood Corporation its mortgage of real and personal property to secure the payment of said \$50,000 in accordance with the terms of said promissory note.

## V.

On or about December 17, 1953, defendant Sutherlin Plywood Corporation and plaintiff executed Exhibit A. Exhibit A designates defendant Suther-



lin Plywood Corporation as party of the first part and plaintiff as party of the second part and provides in part as follows:

“Party of the First Part agrees as compensation for services by Party of the Second Part that an additional 5% of the Mill Value of product shall be retained by Party of the Second Part.”

## VI.

If Exhibit A constituted a contract as alleged in plaintiff's complaint, it was executed in return for a loan of \$50,000 as evidenced by said note. Said interest of 4 per cent on said note and said compensation of 5 per cent of the mill value of products shipped constituted a greater sum or value for the loan or use of money than that prescribed by ORS 82.010.

## Counterclaim

### I.

At all times herein mentioned plaintiff was and now is a corporation organized and existing under and by virtue of the laws of the state of New York.

### II.

At all times herein mentioned defendant Sutherlin Plywood Corporation was and now is a corporation organized and existing under and by virtue of the laws of the state of Oregon.

### III.

As a result of the transactions between plaintiff and defendant Sutherlin Plywood Corporation aris-

ing out of the alleged contract referred to in plaintiff's complaint, defendant Sutherlin Plywood Corporation overpaid plaintiff by the sum of \$6,205.94.

Wherefore, defendant Sutherlin Plywood Corporation prays that all proceedings in the above entitled action be abated. If said action is not abated, defendant Sutherlin Plywood Corporation prays that:

(1) Prior to the trial of this cause the court determine whether plaintiff is entitled to assert a claim for punitive or exemplary damages.

(2) Plaintiff's complaint be dismissed.

(3) Defendant Sutherlin Plywood Corporation have judgment against plaintiff for the sum of \$6,205.94.

(4) Defendant Sutherlin Plywood Corporation have and recover from plaintiff its costs and disbursements herein incurred.

(5) Defendant Sutherlin Plywood Corporation have such other relief as to the court may seem just and equitable.

/s/ GEORGE A. LUOMA,

Attorney for Defendant Sutherlin Plywood Corporation

### EXHIBIT A

This contract made and entered into this 17th day of December, 1953, by and between Sutherlin Plywood Corporation, Party of the First Part, and Oregon Plywood Sales Corporation, Party of the Second Part;

## Witnesseth:

In consideration of the benefits to be derived by each party hereto, Party of the First Part gives and grants unto Party of the Second Part the right to purchase up to 80% of the output of Party of the First Part when Party of the First Part gets into production, and Party of the First Part agrees to accept up to 80% and ship Party of the Second Part's orders as specified and within a reasonable time.

It is further agreed should Party of the First Part not sell the remaining 20% of its product in the ordinary course of business, Party of the Second Part shall have the right to purchase said 20% or part thereof not sold as aforesaid.

It is agreed that the price to be paid for the products of Party of the First Part shall be the wholesale jobber's market price from time to time. If for any reason the parties hereto cannot agree as to this price at any given time, then the price shall be determined by taking the average wholesale jobber's price as evidenced by: 1. Invoices; 2. Quotations; 3. Price lists; of the following ten mills:

Associated Plywood Co.

Anacortes Veneer, Inc.

Georgia-Pacific Plywood Co.

Vancouver Plywood Co.

M & M Woodworking Co.

Northwest Door Co.

Evans Products Co.

Columbia Veneer Co.

Clear Fir Sales Co.

Oregon-Washington Plywood Co.

Party of the Second Part covenants to advance to Party of the First Part 80% of mill value on each car promptly upon receipt of invoice and original bill of lading, balance within ten days after arrival of car at destination, all less 2% cash discount. Value of veneer paid for by Party of the Second Part in each car to be deducted from the payment.

Party of the First Part agrees as compensation for services by Party of the Second Part that an additional 5% of the Mill Value of product shall be retained by Party of the Second Part.

Party of the First Part covenants that it will not sell any of its product to other or others at a price lower than the above mentioned wholesale or jobber's price.

Party of the Second Part covenants to use its best effort to maintain with Party of the First Part a thirty days' order file at the Mill.

It is agreed that there is a mortgage on the mill property of the Party of the First Part to Oregon Plywood Corporation, with certain monthly and annual payments to be made, but in the event Party of the Second Part shall not, at any time or times during the term of said mortgage, furnish sufficient orders to Party of the First Part which would enable Party of the First Part to dispose of 80% of the product of said mill, and for such reason said mill does not operate, then during such period or periods the payments stipulated to be made on said



mortgage shall be deferred until Party of the Second Part shall have furnished Party of the First Part orders which shall enable Party of the First Part to operate its mill continuously for the period of at least two weeks, whereupon the regular payments on the mortgage indebtedness shall resume, and the term of said mortgage shall be extended accordingly.

Party of the First Part shall have the right to reject any orders placed with it by Party of the Second Part, provided specifications are not up to production conditions, nor if unprofitable. All orders shall be deemed accepted unless same shall have been rejected and notices of rejection received by Party of the Second Part within forty-eight (48) hours from receipt of order by Party of the First Part.

It is further agreed that any specification not covered by price procedure above mentioned shall be submitted to Party of the First Part for special price or its approval prior to acceptance of order.

It is further agreed that all plywood shall be manufactured, loaded and shipped in accordance with the Douglas Fir Plywood Association standards and the grade marked thereon, and that the shipping weights will not exceed the following weights per thousand surface feet:  $\frac{1}{4}$ " 790 pounds;  $\frac{5}{16}$ " 950 pounds;  $\frac{3}{8}$ " 1125 pounds;  $\frac{1}{2}$ " 1525 pounds;  $\frac{5}{8}$ " 1825 pounds;  $\frac{3}{4}$ " 2225 pounds.

This sales contract shall be in full force and effect from the beginning of production by Party of the First Part and continue for at least 50



months [but this agreement shall be extended one month for each \$3,000.00 advanced over said \$50,000.00. Initialed: R. F. H., M. Wood.]\* but under no circumstances shall expire until the mortgage by Party of the First Part to Oregon Plywood Corporation shall be paid in full.

It is understood and agreed that if the Party of the First Part is unable to produce because of fire, earthquake, disaster or act of God, this contract shall continue in full force until the mortgage heretofore mentioned is paid in full.

It is further agreed that Party of the Second Part shall acquire one share of stock in Party of the First Part, and Party of the First Part shall keep a representative of Party of the Second Part upon its Board of Directors until the mortgage given by Party of the First Part to Oregon Plywood Corporation shall be paid in full, at which time said share of stock shall be surrendered to Party of the First Part upon Party of the Second Part being paid the original purchase price therefor.

In witness whereof, this agreement has been signed in duplicate by the duly authorized officers of each corporation, and the seal of each such corporation is attached hereto, the date first hereinabove written.

SUTHERLIN PLYWOOD CORPORATION, a corporation,

/s/ By MILLARD WOOD,  
President

---

\*Handwritten.

OREGON PLYWOOD SALES CORPORATION, a corporation,

/s/ By ROBERT F. HOFHEINS

Secretary-Treasurer

Service of Copy Acknowledged.

[Endorsed]: Filed December 13, 1954.

---

[Title of District Court and Cause.]

ANSWER OF DEFENDANT NORDIC  
PLYWOOD, INC.

First Defense

Defendant Nordic Plywood, Inc., pleads in abatement as follows:

I.

Plaintiff is and at all times since the institution of this action has been a corporation organized and existing under and by virtue of the laws of the state of New York.

II.

At the time of the commencement of this action and at all times since, plaintiff had not and has not now obtained certificate of authority from the Corporation Commissioner of the state of Oregon to transact business in the state of Oregon.

III.

By reason of plaintiff's failure to obtain such certificate of authority, plaintiff lacks the capacity to maintain any action, suit or proceeding in this court.

## Second Defense

Comes now defendant Nordic Plywood, Inc., and for its answer to plaintiff's complaint, admits, denies and alleges as follows:

### I.

Admits the allegations of paragraph I.

### II.

Answering the allegations of paragraph II, defendant Nordic Plywood, Inc., admits that plaintiff and defendant Sutherlin Plywood Corporation executed an instrument in which defendant Sutherlin Plywood Corporation purported to grant to plaintiff the right to purchase, at prices therein provided, 80 per cent of the total output of plywood of defendant Sutherlin Plywood Corporation upon terms and conditions therein set forth. Denies each and all the remaining allegations of paragraph II.

### III.

Answering the allegations of paragraph III, defendant Nordic Plywood, Inc., admits that defendant Sutherlin Plywood Corporation sold its plywood mill to defendant Nordic Plywood, Inc., and that after said sale defendant Sutherlin Plywood Corporation possessed no facilities for manufacturing plywood. Denies each and all the remaining allegations of paragraph III.

### IV.

Denies each and all the allegations of paragraph IV.

V.

Denies each and all the allegations of paragraph V.

VI.

Answering the allegations of paragraph VI, defendant Nordic Plywood, Inc., admits that plaintiff has demanded that defendant Nordic Plywood, Inc., sell plywood to plaintiff in accordance with the purported grant contained in said instrument, and has placed orders with defendant Nordic Plywood, Inc., to purchase plywood produced in said mill purportedly on the terms and conditions set forth in said instrument, and that defendant Nordic Plywood, Inc., has wholly refused and failed to fill said orders, or any of them, or otherwise to sell plywood to plaintiff in accordance with said purported grant. Denies each and all the remaining allegations of paragraph VI.

VII.

Denies each and all the allegations of paragraph VII.

Third Defense

Defendant Nordic Plywood, Inc., moves the court for an order striking from the prayer of the complaint the following:

“(d) Awarding plaintiff punitive or exemplary damages against both defendants in the amount of \$50,000.00.”

on the ground that the same is wholly irrelevant and not pertinent to the cause of suit undertaken to be alleged in said pleading.

## Fourth Defense

## I.

On or about December 17, 1953, plaintiff and defendant Sutherlin Plywood Corporation executed a certain instrument, a photostatic copy of which is attached hereto, marked Exhibit A, and by reference made a part hereof. Defendant Nordic Plywood, Inc., is informed and believes and on information and belief alleges that said instrument is the same as the alleged contract referred to in plaintiff's complaint herein.

## II.

The purported grant by defendant Sutherlin Plywood Corporation to plaintiff of a right to purchase 80 per cent of the total output of defendant Sutherlin Plywood Corporation contained in said instrument was made without consideration.

## Fifth Defense

## I.

The alleged contract referred to in plaintiff's complaint and by which defendant Nordic Plywood, Inc., is sought to be charged was and is by its terms not to be performed within a year from the making thereof. Neither said alleged contract, nor any note or memorandum thereof, expresses any consideration.

## II.

Said alleged contract is void under the statutes of frauds, ORS 41.580.



Sixth Defense

I.

Defendant Nordic Plywood, Inc., is a corporation organized and existing under and by virtue of the laws of the state of Oregon.

II.

At all times herein mentioned plaintiff was and now is a corporation organized and existing under and by virtue of the laws of the state of New York. At all times herein mentioned Oregon Plywood Corporation was and now is a corporation organized and existing under and by virtue of the laws of the state of Oregon. Defendant Nordic Plywood, Inc., is informed and believes, and on information and belief alleges, that plaintiff is a subsidiary corporation owned or controlled by Oregon Plywood Corporation.

III.

At all times herein mentioned defendant Sutherlin Plywood Corporation was and now is a corporation organized and existing under and by virtue of the laws of the state of Oregon.

IV.

On or about December 17, 1953, defendant Sutherlin Plywood Corporation made, executed and delivered its promissory note to Oregon Plywood Corporation for the sum of \$50,000, with interest thereon payable at the rate of 4 per cent per annum from date until paid.

## V.

On or about December 17, 1953, defendant Sutherland Plywood Corporation made, executed and delivered to Oregon Plywood Corporation its mortgage of real and personal property to secure the payment of said \$50,000 in accordance with the terms of said promissory note.

## VI.

On or about December 17, 1953, defendant Sutherland Plywood Corporation and plaintiff executed Exhibit A. Exhibit A designates defendant Sutherland Plywood Corporation as party of the first part and plaintiff as party of the second part and provides in part as follows:

“Party of the First Part agrees as compensation for services by Party of the Second Part that an additional 5% of the Mill Value of product shall be retained by Party of the Second Part.”

## VII.

If Exhibit A constituted a contract as alleged in plaintiff's complaint, it was executed in return for a loan of \$50,000 as evidenced by said note. Said interest of 4 per cent on said note and said compensation of 5 per cent of the mill value of products shipped constituted a greater sum or value for the loan or use of money than that prescribed by ORS 82.010.

## Seventh Defense

## I.

Defendant Nordic Plywood, Inc., is a corporation

organized and existing under and by virtue of the laws of the state of Oregon.

## II.

If defendant Nordic Plywood, Inc., interfered with the alleged contract referred to in plaintiff's complaint or induced a breach thereof as alleged in paragraph V of plaintiff's complaint, said interference and said breach were without malice and were privileged for the reason that defendant Nordic Plywood, Inc., had an economic interest in the subject matter of said alleged contract.

Wherefore, having fully answered the allegations of plaintiff's complaint, defendant Nordic Plywood, Inc., prays that all proceedings in the above entitled action be abated. If the action is not abated, defendant Nordic Plywood, Inc., prays that:

(1) Prior to the trial of this cause the court determine whether plaintiff is entitled to assert a claim for punitive or exemplary damages.

(2) The complaint herein be dismissed.

(3) Defendant Nordic Plywood, Inc., have and recover of and from plaintiff its costs and disbursements herein incurred.

(4) Defendant Nordic Plywood, Inc., have such other relief as to the court may seem just and equitable.

KING, MILLER, ANDERSON,  
NASH & YERKE,  
/s/ FREDRIC A. YERKE, JR.,  
Attorneys for Defendant Nordic  
Plywood, Inc.

[Note: Exhibit A is a duplicate of Exhibit A attached to Answer of Sutherlin Plywood Corp. set out at pages 12-17.]

Service of Copy Acknowledged.

[Endorsed]: Filed Dec. 13, 1954.

---

[Title of District Court and Cause.]

REPLY TO COUNTERCLAIM OF DEFEND-  
ANT SUTHERLIN PLYWOOD CORPORA-  
TION

Plaintiff admits the allegations contained in Paragraph I and II of the counterclaim and denies each and every other allegation contained therein.

/s/ JAMES C. DEZENDORF,  
Of Attorneys for Plaintiff.

Service of Copy Acknowledged.

[Endorsed]: Filed Dec. 18, 1954.

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[Title of District Court and Cause.]

PRE-TRIAL ORDER

The above entitled action came on regularly for a pre-trial conference before the undersigned Judge of the above entitled court on the 27th day of February, 1956. Plaintiff appeared by Herbert H. Anderson, one of its attorneys. Defendant Sutherlin Plywood Corporation appeared by George Luoma, Fredric A. Yerke, Jr., and Mark C. Mc-

Clanahan of its attorneys and defendant Nordic Plywood, Inc., appeared by Fredric A. Yerke, Jr., and Mark C. McClanahan of its attorneys. During the course of the pre-trial conference the following facts were agreed upon:

### Agreed Facts

#### I.

Plaintiff is a corporation incorporated under the laws of the State of New York and qualified to do business in Oregon. Defendants are corporations incorporated under the laws of the State of Oregon. The matter in controversy exclusive of interest and costs exceeds \$3,000.00

#### II.

Defendant Sutherlin was organized on November 1, 1951. During November 1951, said corporation purchased a plant site at Sutherlin, Douglas County, Oregon, upon which were situated certain buildings and facilities formerly used in the operation of a sawmill. These buildings and a new building thereafter constructed were used to house the machinery required for the operation of a "plywood lay-up mill." The last of the major items of equipment required for the operation of said mill was delivered during October, 1953. Said mill was not designed to manufacture green veneer, but to process green veneer into plywood.

#### III.

On or about December 17, 1953, plaintiff and de-



defendant Sutherlin Plywood Corporation executed the instrument which is plaintiff's Exhibit 1.

#### IV.

On or about December 17, 1953 defendant Sutherlin Plywood Corporation and Oregon Plywood Corporation entered into the agreement which is plaintiff's Exhibit 2 and defendant Sutherlin in accordance therewith executed and delivered to Oregon Plywood Corporation a note and mortgage, Exhibits 3 and 4.

#### V.

During the months of January, February and March, 1954 defendant Sutherlin Plywood Corporation honored plaintiff's orders and Oregon Plywood Corporation purchased the green veneer which was used by defendant Sutherlin in its operations.

#### VI.

In April, 1954 defendant Sutherlin Plywood Corporation ceased operating its plant. Defendant Sutherlin Plywood Corporation has not supplied plaintiff with any plywood since that date.

#### VII.

In July, 1954 defendant Sutherlin Plywood Corporation began negotiating for the sale of its mill. A special meeting of the board of directors of defendant Sutherlin was held on July 28, 1954 and was attended by the following directors:

Robert F. Hofheins, E. F. Cunningham, C. Millard Wood, C. A. Petherick, Gerald Egan, M. D. Steinbach, Leo Sunnell.

At said meeting the following resolution was adopted:

“Be it resolved, that the Board of Directors shall and it hereby does recommend a sale or lease or any combination of such of all or substantially all of the property and assets of the corporation upon such terms and conditions and for such consideration as the Board of Directors may fix and agree upon for and in behalf of the corporation and its stockholders by contract with a prospective buyer; and, Further, that said recommendation of such sale or lease or any combination of such of all or substantially all of the property and assets of the corporation be submitted to a vote at a special meeting of the shareholders, and that the secretary of the corporation be and he hereby is directed to issue and give notice of a special meeting of the shareholders of the corporation to be held on the 9th day of August, 1954, at 9:00 o'clock A.M., at the main plant building of the corporation in Sutherlin, Oregon, such notice to be given as required by the By-Laws of the corporation and the statutes of the state of Oregon.”

### VIII.

Defendant Sutherlin Plywood Corporation sold its physical assets including the mill to defendant Nordic Plywood, Inc., in September, 1954.

### IX.

Prior to purchasing the physical assets of defendant Sutherlin Plywood Corporation, defendant

Nordic Plywood, Inc. was advised by defendant Sutherlin of the existence of plaintiff's Exhibit I.

### X.

Nordic Plywood, Inc. never intended to furnish plaintiff with 80% of the output of said mill.

### XI.

Plaintiff has demanded that defendant Nordic Plywood, Inc. sell plywood to plaintiff in accordance with Exhibit 1 and has placed orders with defendant Nordic Plywood, Inc. to purchase plywood produced in said mill purportedly on the terms and conditions set forth in said instrument and defendant Nordic Plywood, Inc. has wholly failed and refused to fill said orders, or any of them, or otherwise to sell plywood to plaintiff in accordance with said instrument.

### XII.

Production of plywood by defendant Sutherlin Plywood Corporation in said mill was as follows:

Month (1954)	Production (Board Feet)
January	1,097,648
February	1,095,969
March	1,553,678
April	481,431

Said mill did not operate from April 21, 1954 to September 15, 1954.

## XIII.

The production of plywood by defendant Nordic Plywood, Inc. in said mill has been the following:

Month (1954)	Production (Board Feet)
September	884,000
October	1,980,377
November	1,961,479
December	2,534,493
1955	
January	2,524,718
February	2,434,718
March	2,897,534
April	2,654,318
May	2,799,217
June	2,872,088
July	2,855,621
August	3,528,836
September	3,140,084
October	3,770,300
November	3,282,582
December	
1956	
January	
February	

## XIV.

No officer, director or stockholders of defendant Nordic Plywood, Inc. is or at any time since December 17, 1953, has been an officer, stockholder or director of defendant Sutherlin Plywood Corporation.

## XV.

At all times herein mentioned the officers of plaintiff were and now are: President, Franklin A. Hofheins, Secretary, Robert F. Hofheins, Treasurer, Robert F. Hofheins, and the directors of plaintiff were and now are: L. L. Swan, Franklin A. Hofheins, Robert F. Hofheins, Alfred Young, Thomas S. Dennis.

At all times herein mentioned plaintiff was and now is engaged in purchasing and selling plywood.

At all times herein mentioned Oregon Plywood Corporation was and now is an Oregon corporation engaged in the operation of a plywood mill in Sweet Home, Linn County, Oregon. At all times herein mentioned the officers of Oregon Plywood Corporation were and now are: President, Franklin A. Hofheins, Vice-President, Robert F. Hofheins, Secretary, L. L. Swan, Treasurer, Robert F. Hofheins, and the directors of Oregon Plywood Corporation were and now are: L. L. Swan, Franklin A. Hofheins, Robert F. Hofheins, Alfred Young, Thomas S. Dennis.

At all times herein mentioned plaintiff was and now is a wholly owned subsidiary of Oregon Plywood Corporation.

## XVI.

On December 17, 1953, the officers of Sutherlin were and now are: President, C. Millard Wood, Secretary, M. D. Steinbach, Treasurer, (Blank), Chairman of the Board of Directors, E. F. Cunningham, and its directors were: E. F. Cunningham,



C. Millard Wood, C. A. Petherick, Gerald Egan, M. D. Steinbach, Leo Sunnell.

### XVII.

Defendant Nordic Plywood, Inc. was incorporated on September 3, 1954. Since its incorporation the officers of Nordic have been and now are: President, J. R. Adams, Secretary-Treasurer, Norman Jacobson, and the directors were and now are: J. R. Adams, Norman Jacobson, Raleigh Chinn.

### XVIII.

Oregon Plywood Corporation loaned \$80,000.00 to defendant Sutherlin Plywood Corporation and said money was received by defendant Sutherlin Plywood Corporation. No further loans were made to defendant Sutherlin Plywood Corporation by Oregon Plywood Corporation. Said loan has been repaid to Oregon Plywood Corporation.

### XIX.

Defendant Nordic Plywood, Inc. knew prior to its purchase of said mill from defendant Sutherlin Plywood Corporation that after said purchase defendant Sutherlin Plywood Corporation would be unable to furnish plywood to plaintiff from said mill. Said mill was the only mill ever operated by defendant Sutherlin Plywood Corporation.

#### Plaintiff's Contentions

1. Plaintiff and defendant Sutherlin Plywood Corporation entered into an agreement on or about December 17, 1953, whereby plaintiff agreed to:

(1) Procure a loan for defendant Sutherlin in the amount of \$80,000.00.

(2) Procure the purchase of the green veneer used by defendant Sutherlin.

(3) Use its best efforts to maintain a 30-day order file at defendant Sutherlin's mill for its product.

(4) Advance 80% of the mill value of defendant Sutherlin's product upon receipt of invoices therefor.

(5) Procure a deferment on repayment of said loan of \$80,000.00 if plaintiff did not furnish orders up to 80% of defendant Sutherlin's production.

and defendant Sutherlin agreed to:

(1) Grant plaintiff the right to purchase up to 80% of its output and to accept and ship plaintiff's orders within a reasonable time.

(2) Grant plaintiff the wholesale jobber's market price less 5% as compensation for plaintiff's services.

(3) Continue said sales agreement for 50 months.

2. Said agreement between plaintiff and defendant Sutherlin is evidenced by two written instruments signed by defendant Sutherlin on December 17, 1953, Exhibits 1 and 2.

3. Plaintiff performed its portion of said agreement but said agreement was breached by defendant Sutherlin's sale of its mill and by the failure of

either defendant to furnish plaintiff 80% of the output of said mill.

4. Defendant Nordic Plywood, Inc., unlawfully interfered with the agreement between plaintiff and defendant Sutherlin and induced a breach thereof and conspired with defendant Sutherlin to destroy plaintiff's rights under said agreement.

5. Plaintiff has suffered compensatory damages in the amount of 5% of the mill value of 80% of the product of said mill.

6. Plaintiff is entitled to punitive damages in the amount of \$100,000.00.

7. Defendants should be enjoined from operating said mill unless they furnish plaintiff 80% of the output of said mill for 47 months.

8. Plaintiff denies defendants' contentions.

9. Defendant Sutherlin represented that it intended to operate for at least 50 months and it acted in bad faith in ceasing operations and in disabling itself from further performance by selling its plant.

10. There is due plaintiff by defendant Sutherlin Plywood Corporation on open account the sum of \$3,824.78 pursuant to an account assigned to plaintiff by Oregon Plywood Corporation.

11. Plaintiff could not buy elsewhere at the same price promised in Exhibit 1.

12. Plaintiff is ready, willing and able to perform under Exhibit 1.

Defendant Sutherlin Plywood  
Corporation's Contentions

I.

The instrument marked plaintiff's exhibit 1 and the purported grant by defendant Sutherlin Plywood Corporation to plaintiff of a right to purchase 80 per cent of the total output of defendant Sutherlin Plywood Corporation is not now and was never enforceable against or binding upon defendant Sutherlin Plywood Corporation for the following reasons:

(a) Said instrument and said purported grant were executed and made without any legally sufficient or adequate consideration.

(b) Said instrument and said purported grant are void under the statute of frauds, ORS 41.580, in that the terms of said instrument and said grant could not be performed within one year from the date thereof and neither said instrument nor any memorandum of said grant expresses any consideration therefor.

(c) If said instrument and said purported grant are otherwise valid and enforceable, they were executed and given in return for a contemporaneous loan of \$50,000 as evidenced by the note marked plaintiff's exhibit 3. The interest on said loan, together with the 5 per cent discount on the mill value of products shipped, provided for in plaintiff's exhibit 1, constituted a greater sum or value for the loan of money than that prescribed by ORS 82.010

and, accordingly, said instrument and grant are illegal and usurious.

## II.

If said instrument and said purported grant were valid and enforceable contractual obligations, defendant Sutherlin Plywood Corporation was excused from further performing said obligations by reason of present and prospective material failure of consideration and numerous breaches thereof by plaintiff as follows:

(1) Plaintiff failed to advance 80 per cent of the mill value on each car of plywood shipped promptly upon receipt of invoice and original bill of lading.

(2) Plaintiff retained the entire price of numerous shipments of plywood after arrival of the railroad cars at destination and failed to remit to defendant Sutherlin Plywood Corporation therefor for an unreasonable length of time.

(3) Plaintiff failed to use its best effort to maintain with defendant Sutherlin Plywood Corporation a 30 days' order file at its mill.

(4) The orders placed by plaintiff with defendant Sutherlin Plywood Corporation were unprofitable.

## III.

If said instrument and said purported grant were valid and enforceable contractual obligations, defendant Sutherlin Plywood Corporation at no time breached said obligations, and

(a) At no time failed to grant to plaintiff the



right to purchase up to 80 per cent of its output, and

(b) By the terms of said instrument and said purported grant, defendant Sutherlin Plywood Corporation had no obligation to maintain a particular or any output and was free to shut down its mill and thereafter to sell its mill to defendant Nordic Plywood, Inc., or

(c) If, under the terms of said instrument and said purported grant, defendant Sutherlin Plywood Corporation had any duty to maintain a particular or any output or any duty to refrain from selling its mill, nevertheless said duty was not violated in that the shutdown of said mill and the subsequent sale of the physical assets of the corporation, including said mill, were done in good faith and were made necessary by the poor financial condition of defendant Sutherlin Plywood Corporation.

#### IV.

If plaintiff is entitled to any relief in this action, it is not entitled to an injunction for the following reasons:

(a) Plaintiff's legal remedies are adequate.

(b) Plaintiff has been guilty of laches in that, although it knew long before the sale thereof that defendant Sutherlin Plywood Corporation intended to sell its mill, it nevertheless failed to raise any objection thereto or assert any rights under the instrument marked plaintiff's exhibit 1, thereby

misleading defendant Nordic Plywood, Inc., and inducing it to purchase said mill.

(c) Plaintiff has unclean hands in that plaintiff's exhibit 1 was part of an illegal and usurious transaction.

(d) Defendant Sutherlin Plywood Corporation has no control over said mill.

## V.

If plaintiff is entitled to compensatory damages in this action, 5 per cent of the mill value of 80 per cent of the product of said mill is not the proper measure of such damages. Plaintiff is not entitled to more than nominal damages.

## VI.

If plaintiff is entitled to any relief in this action, it is not entitled to punitive or exemplary damages from defendant Sutherlin Plywood Corporation for the reasons that:

(a) Plaintiff has waived its right to such damages by seeking relief in equity and it cannot obtain such damages and such equitable relief on the same cause of action.

(b) Such damages are not recoverable for breach of contract.

(c) If defendant Sutherlin Plywood Corporation breached its contractual obligations, its acts in that regard were done in good faith and without malice.

## VII.

In the transactions between plaintiff and defendant Sutherlin Plywood Corporation arising out of

their account relationships in the sale and delivery of plywood and the purchase and receipt thereof by plaintiff under the instrument marked plaintiff's Exhibit 1, plaintiff became and now is indebted to defendant Sutherlin Plywood Corporation in the sum of \$4,101.39 as the balance of their mutual accounts over and above all payments made, the discounts and credits to which plaintiff was entitled under plaintiff's Exhibits 1 and 2, and the advances made by plaintiff to defendant Sutherlin Plywood Corporation. Plaintiff has failed and refused to pay said balance or any part thereof and defendant Sutherlin Plywood Corporation is entitled to judgment against plaintiff therefor in the sum of \$4,101.39, together with interest thereon at the rate of 6 per cent per annum from May 31, 1954.

### VIII.

Defendant Sutherlin Plywood Corporation denies each of plaintiff's contentions.

Defendant Nordic Plywood, Inc.'s Contentions.

#### I.

The instrument marked plaintiff's exhibit 1 and the purported grant by defendant Sutherlin Plywood Corporation to plaintiff of a right to purchase 80 per cent of the total output of defendant Sutherlin Plywood Corporation is not now and was never enforceable against or binding upon defendant Sutherlin Plywood Corporation for the following reasons:

(a) Said instrument and said purported grant

were executed and made without any legally sufficient or adequate consideration.

(b) Said instrument and said purported grant are void under the statute of frauds, ORS 41.580, in that the terms of said instrument and said grant could not be performed within one year from the date thereof and neither said instrument nor any memorandum of said grant expresses any consideration therefor.

(c) If said instrument and said purported grant are otherwise valid and enforceable, they were executed and given in return for a contemporaneous loan of \$50,000 as evidenced by the note marked plaintiff's exhibit 3. The interest on said loan, together with the 5 per cent discount on the mill value of products shipped, provided for in plaintiff's exhibit 1, constituted a greater sum or value for the loan of money than that prescribed by ORS 82.010 and, accordingly, said instrument and grant are illegal and usurious.

## II.

If said instrument and said purported grant were valid and enforceable contractual obligations, defendant Sutherlin Plywood Corporation was excused from further performing said obligations by reason of present and prospective material failure of consideration and numerous breaches thereof by plaintiff as follows:

(1) Plaintiff failed to advance 80 per cent of the mill value on each car of plywood shipped promptly upon receipt of invoice and original bill of lading.

(2) Plaintiff retained the entire price of numer-

ous shipments of plywood after arrival of the railroad cars at destination and failed to remit to defendant Sutherlin Plywood Corporation therefor for an unreasonable length of time.

(3) Plaintiff failed to use its best effort to maintain with defendant Sutherlin Plywood Corporation a 30 days' order file at its mill.

(4) The orders placed by plaintiff with defendant Sutherlin Plywood Corporation were unprofitable.

### III.

If said instrument and said purported grant were valid and enforceable contractual obligations, defendant Sutherlin Plywood Corporation at no time breached said obligations, and

(a) At no time failed to grant to plaintiff the right to purchase up to 80 per cent of its output, and

(b) By the terms of said instrument and said purported grant, defendant Sutherlin Plywood Corporation had no obligation to maintain a particular or any output and was free to shut down its mill and thereafter to sell its mill to defendant Nordic Plywood, Inc., or

(c) If, under the terms of said instrument and said purported grant, defendant Sutherlin Plywood Corporation had any duty to maintain a particular or any output or any duty to refrain from selling its mill, nevertheless said duty was not violated in that the shutdown of said mill and the subsequent sale of the physical assets of the corporation, including said mill, were done in good faith and were



made necessary by the poor financial condition of defendant Sutherlin Plywood Corporation.

#### IV.

If said instrument and said purported grant were valid and enforceable contractual obligations of defendant Sutherlin Plywood Corporation and if defendant Sutherlin Plywood Corporation breached said obligations, said breach occurred long prior to defendant Nordic Plywood, Inc.'s purchase of said mill, and said purchase did not and could not interfere with the performance thereof or cause a breach thereof or defeat plaintiff's rights therein.

#### V.

If defendant Nordic Plywood, Inc., interfered with any contract between plaintiff and defendant Sutherlin Plywood Corporation, or caused a breach thereof or defeated plaintiff's rights therein, such act was in good faith, without malice and occurred by reason of defendant Nordic Plywood, Inc.'s competition with plaintiff for the production of said mill and by reason of the pursuit by defendant Nordic Plywood, Inc., of its legitimate economic interests. Accordingly, any such interference was privileged.

#### VI.

If plaintiff is entitled to any relief in this action, it is not entitled to an injunction for the following reasons:

- (a) Plaintiff's legal remedies are adequate.
- (b) Plaintiff has been guilty of laches in that,

although it knew long before the sale thereof that defendant Sutherlin Plywood Corporation intended to sell its mill, it nevertheless failed to raise any objection thereto or assert any rights under the instrument marked plaintiff's exhibit 1, thereby misleading defendant Nordic Plywood, Inc., and inducing it to purchase said mill.

(c) Plaintiff has unclean hands in that plaintiff's exhibit 1 was part of an illegal and usurious transaction.

## VII.

If plaintiff is entitled to compensatory damages in this action, 5 per cent of the mill value of 80 per cent of the product of said mill is not the proper measure of such damages. Plaintiff is not entitled to more than nominal damages.

## VIII.

If plaintiff is entitled to any relief in this action, it is not entitled to punitive or exemplary damages against defendant Nordic Plywood, Inc., for the reasons that:

(a) Plaintiff has waived its right to such damages by seeking relief in equity and it cannot obtain such damages and such equitable relief on the same cause of action.

(b) If defendant Nordic Plywood, Inc., unlawfully interfered with or induced the breach of any contract between plaintiff and defendant Sutherlin Plywood Corporation, all of defendant Nordic Plywood, Inc.'s acts in that regard were done in good faith and without malice.

IX.

Defendant Nordic Plywood, Inc., denies each of plaintiff's contentions.

Issues

1. Did the parties make the agreement described in plaintiff's contention number 1?
2. If said agreement or any agreement was made,
  - (a) is there sufficient consideration therefor?
  - (b) is it spurious?
  - (c) is it within the statute of frauds, and, if so, was there compliance with said statute?
3. Did defendant Sutherlin Plywood Corporation breach said agreement by the sale of its mill and by failure of either defendant to permit plaintiff to purchase 80 per cent of the output of said mill?
4. Was defendant Sutherlin Plywood Corporation excused from performance of said agreement by a material failure of consideration or by breaches by plaintiff?
5. If there was a valid and enforceable agreement and if it was breached by defendant Sutherlin Plywood Corporation, did defendant Nordic Plywood, Inc., unlawfully interfere with said contract and induce a breach thereof and conspire with defendant Sutherlin Plywood Corporation to destroy plaintiff's rights therein?
6. Should defendants be enjoined from operating said mill unless they furnish plaintiff 80 per cent of the output of said mill for 47 months?

7. What, if any, compensatory damages should plaintiff recover?

8. What, if any, punitive damages should plaintiff recover?

9. What amount, if any, should defendant Sutherlin Plywood Corporation recover on its counterclaim?

#### Plaintiff's Exhibits

1. Agreement between plaintiff and defendant Sutherlin Plywood Corporation dated December 17, 1953.

2. Agreement between Oregon Plywood Corporation and defendant Sutherlin Plywood Corporation dated December 17, 1953.

3. Note from defendant Sutherlin Plywood Corporation to Oregon Plywood Corporation.

4. Mortgage from defendant Sutherlin Plywood Corporation to Oregon Plywood Corporation.

5. Financial statements and reports of defendant Sutherlin Plywood Corporation.

6. Financial statements and reports of defendant Nordic Plywood, Inc.

7. Letter from George Luoma to plaintiff dated August 20, 1954.

8. Letter from George Luoma to plaintiff dated September 14, 1954.

9. Statement of account between plaintiff and defendant Sutherlin Plywood Corporation.

10. Correspondence between plaintiff and defendant Sutherlin Plywood Corporation.
11. Orders from plaintiff to defendant Sutherlin Plywood Corporation.
12. Schedule of plaintiff's orders canceled by defendant Sutherlin Plywood Corporation.
13. Invoices from Sutherlin Plywood Corporation to plaintiff.
14. Deposition of Harold Jacobsen.
15. Deposition of Charles Millard Wood.
16. Deposition of John Richard Adams.
17. Deposition of George Luoma.
18. Deposition of Marvin D. Steinbach.
19. Deposition of Charles Albert Pethric.
20. Deposition of Norbert L. Patterson.
21. Deposition of Eugene F. Cunningham.
22. Deposition of Snyder J. King.
23. Orders placed by plaintiff in October, 1954, and Nordic's reply.
24. Summary of plaintiff's open account claim.
25. Assignment of open account claim by Oregon Plywood Corporation to plaintiff.
26. Calls made by plaintiff trying to replace Sutherlin productions.
27. Douglas Fir Plywood Association Barometer Reports.
28. Crow's Weekly Letter.



## Defendants' Exhibits

No.	Description
101.	Deposition of Robert Hofheins.
102.	Deposition of Norbert L. Patterson.
103.	Deposition of Charles Millard Wood.
104.	Deposition of George Luoma.
105.	Deposition of John Richard Adams.
106.	Deposition of Norman Harold Jacobson.
107.	Deposition of Marvin D. Steinbach.
108.	Deposition of Charles Albert Pethric.
109.	Deposition of Snyder J. King.
110.	Deposition of Eugene F. Cunningham.
111.	Deposition of Norman H. Pritchard.
112.	Instrument executed by plaintiff and defendant Sutherlin Plywood Corporation dated December 17, 1953.
113.	Agreement between Oregon Plywood Corporation and defendant Sutherlin Plywood Corporation, dated December 17, 1953.
114.	Note from defendant Sutherlin Plywood Corporation to Oregon Plywood Corporation, dated December 17, 1953.
115.	Mortgage from defendant Sutherlin Plywood Corporation to Oregon Plywood Corporation, dated December 17, 1953.
116.	Assignment from defendant Sutherlin Plywood Corporation to plaintiff dated April 28, 1954.
117.	Memorandum Agreement between defendant Sutherlin Plywood Corporation and plaintiff, dated April 5, 1954.

118. Notice to Creditors of defendant Sutherlin Plywood Corporation, dated August 24, 1954.

119. Earnest Money Receipt and Agreement between defendant Sutherlin Plywood Corporation and Norman Jacobson and J. R. Adams, dated August 16, 1954.

120. Conditions of Sale instrument by defendant Sutherlin Plywood Corporation to defendant Nordic Plywood, Inc., dated September 7, 1954.

121. Escrow Instructions from defendants Sutherlin Plywood Corporation and Nordic Plywood, Inc., to Seattle-First National Bank, dated September 7, 1954.

122. Escrow Instructions from Seattle-First National Bank to Commercial Abstract Company, dated September 24, 1954.

123. Note from defendant Nordic Plywood, Inc., to defendant Sutherlin Plywood Corporation, dated September 7, 1954.

124. Mortgage from defendant Nordic Plywood, Inc., to defendant Sutherlin Plywood Corporation, dated September 7, 1954.

125. Orders from plaintiff to defendant Sutherlin Plywood Corporation.

126. Invoices from defendant Sutherlin Plywood Corporation to plaintiff.

127. Invoices from defendant Sutherlin Plywood Corporation to the trade.

128. Correspondence between defendant Sutherlin Plywood Corporation and plaintiff.

129. Correspondence between defendant Sutherlin Plywood Corporation and Oregon Plywood Corporation.

130. Notice from defendant Sutherlin Plywood Corporation to Robert Hofheins, Jr., dated July 24, 1954.

131. Balance Sheets and Income Statements of defendant Sutherlin Plywood Corporation.

132. Accounting Records of defendant Sutherlin Plywood Corporation.

133. Balance Sheets and Income Statements of defendant Nordic Plywood, Inc.

134. Corporate Minute Book of defendant Sutherlin Plywood Corporation.

135. Corporate Minute Book of defendant Nordic Plywood, Inc.

136. Letter to J. R. Adams from C. John Newlands, dated June 28, 1954.

137. Letter to defendant Sutherlin Plywood Corporation from Weter, Roberts & Shefelman, dated June 28, 1954.

138. Letter to defendant Sutherlin Plywood Corporation from Theodore S. Bloom, dated June 10, 1954.

139. Telegram from E. Cunningham to Robert Hofheins, dated June 3, 1954.

140. Telegram from Robert F. Hofheins to E. Cunningham, dated June 4, 1954.

141. Letter from Oregon Plywood Corporation to Millard Wood, dated May 19, 1954.

142. Correspondence between James C. Dezen-dorf and George Luoma.

143. Summary of Computation of Counterclaim.

144. Orders and Invoices between plaintiff and Oregon Plywood Corporation.

145. Invoices for veneer purchased by Oregon Plywood Corporation for defendant Sutherlin Plywood Corporation.

146. Schedule of Discounts received by plaintiff from defendant Sutherlin Plywood Corporation.

147. Announcement of plaintiff, dated December 29, 1953.

148. Plaintiff's Price List of March 11, 1954.

149. Letter from Defendant's to Nordic dated Oct. 18, 1954.

150. Letter from Defendant's to Nordic Dated Oct. 19, 1954.

154. Reconciliation of Defendant's open account to 143.

The parties hereto agree to the foregoing pre-trial order, and the court being advised in the premises,

Now Orders that the foregoing pre-trial order shall not be amended, except by consent of both parties or to prevent manifest injustice; and it is further

Ordered that the pre-trial order supersedes all pleadings; and it is further

Ordered that upon the trial of this cause no proof shall be required as to matters of fact hereinabove specifically agreed to by the parties, but that proof

upon the issues of fact and law between plaintiff and defendant as hereinabove stated shall be had.

Dated at Portland, Oregon, this 27th day of March, 1956.

/s/ GUS J. SOLOMON,

Judge

Approved:

/s/ HERBERT H. ANDERSON,

Of Attorneys for Plaintiff

/s/ FREDRIC A. YERKE, JR.,

Of Attorneys for Defendants Sutherland Plywood Corporation and Nordic Plywood, Inc.

[Endorsed]: Filed March 27, 1956.

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[Title of District Court and Cause.]

## FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled-and-numbered action came on regularly for trial on March 27, 1956, before the Honorable Gus J. Solomon, judge of the above-entitled court. Plaintiff appeared by and through Herbert H. Anderson, one of its attorneys. Defendants appeared by and through Fredric A. Yerke, Jr., George A. Luoma, and Mark C. Clanahan, of their attorneys. The court having heard and considered all the evidence and statements of counsel, having examined briefs of the parties, having carefully considered all the issues of fact and law presented, and having rendered its opinion at the close of the



evidence, and being fully advised in the premises, does hereby make and enter the following:

### Findings of Fact

#### I.

Plaintiff is a corporation incorporated under the laws of the State of New York and qualified to do business in Oregon. Defendants are corporations incorporated under the laws of the State of Oregon. The matter in controversy, exclusive of interest and costs, exceeds \$3,000.

#### II.

At all times herein mentioned the officers of plaintiff were and now are: President, Franklin A. Hofheins; Secretary, Robert F. Hofheins; Treasurer, Robert F. Hofheins; and the directors of plaintiff were and now are: L. L. Swan, Franklin A. Hofheins, Robert F. Hofheins, Alfred Yourg, Thomas S. Dennis. At all times herein mentioned plaintiff was and now is engaged in purchasing and selling plywood.

At all times herein mentioned Oregon Plywood Corporation was and now is an Oregon corporation engaged in the operation of a plywood mill in Sweet Home, Linn County, Oregon. At all times herein mentioned the officers of Oregon Plywood Corporation were and now are: President, Franklin A. Hofheins; Vice-President, Robert F. Hofheins; Secretary, L. L. Swan; Treasurer, Robert F. Hofheins; and the directors of Oregon Plywood Corporation were and now are: L. L. Swan, Franklin A. Hofheins, Robert F. Hofheins, Alfred Yourg, Thomas

S. Dennis. At all times herein mentioned plaintiff was and now is a wholly owned subsidiary of Oregon Plywood Corporation.

### III.

Defendant Sutherlin Plywood Corporation was organized on November 1, 1951. During November, 1951, said corporation purchased a plant site at Sutherlin, Douglas County, Oregon, upon which were situated certain buildings and facilities formerly used in the operation of a sawmill. These buildings and a new building thereafter constructed were used to house the machinery required for the operation of a "plywood layup mill." The last of the major items of equipment required for the operation of said mill was delivered during October, 1953. Said mill was not designed to manufacture green veneer, but to process green veneer into plywood.

### IV.

On December 17, 1953, the officers of Sutherlin Plywood Corporation were and now are: President, C. Millard Wood; Secretary, M. D. Steinbach; Treasurer, C. A. Petherick; Chairman of the Board of Directors, E. F. Cunningham; and its directors were: E. F. Cunningham, C. Millard Wood, C. A. Petherick, Gerald Egan, M. D. Steinbach, Leo Sunnell.

### V.

On or about December 17, 1953, plaintiff and defendant Sutherlin Plywood Corporation executed the instrument which is plaintiff's Exhibit 1.

On or about December 17, 1953, defendant Sutherlin Plywood Corporation and Oregon Plywood Corporation entered into the agreement which is plaintiff's Exhibit 2, and defendant Sutherlin Plywood Corporation in accordance therewith executed and delivered to Oregon Plywood Corporation a note and mortgage, plaintiff's Exhibits 3 and 4.

## VI.

In early January, 1954, pursuant to the provisions of the last paragraph of plaintiff's Exhibit 1, Robert F. Hofheins was elected to the board of directors of defendant Sutherlin Plywood Corporation, and he has remained a director on said board since that date.

## VII.

Oregon Plywood Corporation loaned \$80,000 to defendant Sutherlin Plywood Corporation, and said money was received by defendant Sutherlin Plywood Corporation. No further loans were made to defendant Sutherlin Plywood Corporation by Oregon Plywood Corporation. Said loan was fully repaid to Oregon Plywood Corporation in November, 1954, as a part of the sale of defendant Sutherlin Plywood Corporation's physical assets hereinafter described.

## VIII.

At the time the instrument marked plaintiff's Exhibit 1 was executed, plaintiff and Robert F. Hofheins, the person who conducted the negotiations on behalf of plaintiff which led to the execu-

tion thereof, had had extensive experience in the plywood industry and knew that the condition of the market was not favorable to the prospects of successful operation of a newly organized plywood company organized as was defendant Sutherlin Plywood Corporation. They knew the financial condition of defendant Sutherlin Plywood Corporation and that it was weak financially and was in dire need of working capital. They knew of and appreciated the risks that defendant Sutherlin Plywood Corporation might not be able to operate profitably and might be compelled to shut down. They knew of and appreciated the risk that the management of a small plywood company such as defendant Sutherlin Plywood Corporation might not be able to keep the mill in operating condition.

#### IX. [Struck out]

#### X.

Defendant Sutherlin Plywood Corporation completed construction of its plywood manufacturing facilities at Sutherlin, Oregon, in December, 1953. Operation of said mill commenced in early January, 1954, and continued until April 21, 1954, when production was terminated because of the poor financial condition of defendant Sutherlin Plywood Corporation and the generally poor market conditions in the plywood industry then existing. Said mill did not resume operations until September 15, 1954, as hereinafter set forth. The amount of plywood pro-

duced by defendant Sutherlin Plywood Corporation during 1954 was as follows:

Month (1954)	Production (Board Feet)
January	1,097,648
February	1,095,969
March	1,553,678
April	481,431

Its net losses during the first five months of 1954 resulted from its operations and were as follows:

Month (1954)	Net Losses
January	\$22,604.99
February	46,380.69
March	29,624.62
April	18,131.51
May	9,224.91
Total net losses	\$125,966.72

Neither plaintiff nor Oregon Plywood Corporation loaned additional money or extended any other financial assistance to defendant Sutherlin Plywood Corporation after the operation of said mill had ceased.

During the period of the operation of said mill by defendant Sutherlin Plywood Corporation, it employed approximately 100 persons and all but three of four of its employees were also stockholders of Sutherlin Plywood Corporation.

## XI.

During the months of January, February and



March, 1954, defendant Sutherlin Plywood Corporation honored plaintiff's orders and Oregon Plywood Corporation purchased the green veneer which was used by defendant Sutherlin Plywood Corporation in its operations.

## XII.

Defendant Sutherlin Plywood Corporation has not produced any plywood or supplied plaintiff with any plywood since April 21, 1956, except for small amounts left on hand at the time operations ceased.

## XIII.

At the time defendant Sutherlin Plywood Corporation commenced operating said mill, it was weak financially and its capital was impaired. At the time it ceased operations, it was and at all times since that date it has been unable to pay its obligations as they matured.

## XIV.

At the time defendant Sutherlin Plywood Corporation ceased operations, its working capital was completely depleted. Its secured and unsecured creditors were demanding payment of delinquent obligations. It had twice failed to meet its payroll on time, and had been threatened with labor liens. Its electrical power had been turned off because the bill therefor had not been paid. From the time it ceased operations until it sold its mill, expenses for the care and maintenance of said mill continued, but it lacked sufficient money to pay for its electrical power, the premiums for insurance for said mill, a watchman for said mill, or its creditors.

## XV.

When its working capital became depleted, the directors of defendant Sutherlin Plywood Corporation, with the exception of Robert F. Hofheins, actively, diligently and persistently sought additional financing for the purpose of reopening the mill, but they were unsuccessful in their efforts to obtain it.

## XVI.

In early June, 1954, the stockholders of defendant Sutherlin Plywood Corporation authorized its directors to seek to sell or lease said mill, and in early June, 1954, defendant Sutherlin Plywood Corporation decided it would sell or lease said mill, if possible. From that time forward it actively sought to find a possible buyer or lessee thereof and invited offers therefor.

## XVII.

In July, 1954, defendant Sutherlin Plywood Corporation began negotiating for the sale of its mill. A special meeting of the board of directors of defendant Sutherlin Plywood Corporation was held on July 28, 1954, and was attended by the following directors: Robert F. Hofheins, E. F. Cunningham, C. Millard Wood, C. A. Petherick, Gerald Egan, M. D. Steinbach, Leo Sunnell.

At said meeting the following resolution was adopted:

“Be It Resolved, that the Board of Directors shall and it hereby does recommend a sale or lease or any combination of such of all or substantially all of the property and assets of the corporation upon such terms and conditions and for such con-

sideration as the Board of Directors may fix and agree upon for and in behalf of the corporation and its stockholders by contract with a prospective buyer; and, Further, that said recommendation of such sale or lease or any combination of such of all or substantially all of the property and assets of the corporation be submitted to a vote at a special meeting of the shareholders, and that the secretary of the corporation be and he hereby is directed to issue and give notice of a special meeting of the shareholders of the corporation to be held on the 9th day of August, 1954, at 9:00 o'clock A.M., at the main plant building of the corporation in Sutherlin, Oregon, such notice to be given as required by the By-Laws of the corporation and the statutes of the state of Oregon."

### XVIII.

In early August, 1954, defendant Sutherlin Plywood Corporation accepted an offer from J. R. Adams and Norman H. Jacobson for the sale and purchase of its physical assets, including said mill; said offer had been made pursuant to said invitations for offers made by defendant Sutherlin Plywood Corporation. Thereafter said J. R. Adams and Norman H. Jacobson caused defendant Nordic Plywood, Inc., to be incorporated.

### XIX.

Defendant Nordic Plywood, Inc., was incorporated on September 3, 1954. Since its incorporation the officers of Nordic Plywood, Inc., have been and now are: President, J. R. Adams, Secretary-Treasurer, Norman H. Jacobson, and the directors were

and now are: J. R. Adams, Norman H. Jacobson, Raleigh Chinn.

No officer, directors or stockholder of defendant Nordic Plywood, Inc., is or at any time since December 17, 1953, has been an officer, stockholder or director of defendant Sutherlin Plywood Corporation.

## XX.

Defendant Sutherlin Plywood Corporation sold its physical assets, including the mill, to defendant Nordic Plywood, Inc., in September, 1954.

## XXI.

By the terms of said sale, the installments on the purchase price were and are paid into escrow and distributed to the creditors, and any remaining equity will ultimately be distributed to defendant Sutherlin Plywood Corporation and its stockholders.

## XXII.

At the time defendant Sutherlin Plywood Corporation ceased operations at said mill, at the time of the acceptance of said offer of J. R. Adams and Norman H. Jacobson, and at the time of said sale to defendant Nordic Plywood, Inc., defendant Sutherlin Plywood Corporation had already become disabled through no fault of its own from furnishing plaintiff with any output of said mill or honoring plaintiff's orders for plywood.

## XXIII.

In ceasing operations, seeking to sell or lease its physical assets, and in selling its physical assets, defendant Sutherlin Plywood Corporation and the

officers, directors and stockholders thereof acted in good faith. The decisions so to do were the result of the exercise of honest and reasonable business judgment. At the time of said sale, defendant Sutherlin Plywood Corporation had no alternatives but to sell its physical assets or face continued and additional losses and, ultimately, bankruptcy.

#### XXIV.

Prior to purchasing the physical assets of defendant Sutherlin Plywood Corporation, defendant Nordic Plywood, Inc., was advised by defendant Sutherlin Plywood Corporation of the existence of Plaintiff's Exhibit 1.

Nordic Plywood, Inc., never intended to furnish plaintiff with 80 per cent of the output of said mill.

#### XXV.

Defendant Nordic Plywood, Inc., knew prior to its purchase of said mill from defendant Sutherlin Plywood Corporation that after said purchase defendant Sutherlin Plywood Corporation would be unable to furnish plywood to plaintiff from said mill. Said mill was the only mill ever operated by defendant Sutherlin Plywood Corporation.

#### XXVI.

Defendant Nordic Plywood, Inc., did not induce defendant Sutherlin Plywood Corporation to sell said mill. Defendant Sutherlin Plywood Corporation had decided to sell its physical assets prior to its negotiations with said J. R. Adams and Norman H. Jacobson.

#### XXVII.

There was no collusion, conspiracy or agreement



between defendant Sutherlin Plywood Corporation and defendant Nordic Plywoods, Inc., to destroy plaintiff's rights in the instrument marked plaintiff's Exhibit 1 and in consummating said sale defendant Nordic Plywood, Inc., acted in good faith and for the purpose solely of acquiring said physical assets for its own purposes. It had no purpose or intent to damage plaintiff or destroy its rights in said instrument.

## XXVIII.

Defendant Nordic Plywood, Inc., has operated said mill since September 15, 1954, and the production of plywood by defendant Nordic Plywood, Inc., in said mill from said date through November, 1955, was as follows:

Month (1954)	Production (Board Feet)
September	884,000
October	1,980,377
November	1,961,479
December	2,534,493
(1955)	
January	2,524,718
February	2,434,718
March	2,897,534
April	2,654,318
May	2,799,217
June	2,872,088
July	2,855,621
August	3,528,836
September	3,140,084
October	3,770,300
November	3,282,582

Plaintiff has demanded that defendant Nordic Plywood, Inc., sell plywood to plaintiff in accordance with plaintiff's Exhibit 1, and has placed orders with defendant Nordic Plywood, Inc., to purchase plywood produced in said purportedly on the terms and conditions set forth in said instrument, and defendant Nordic Plywood, Inc., has wholly failed and refused to fill said orders, or any of them, or otherwise to sell plywood to plaintiff in accordance with said instrument.

## XXIX.

There is due and owing by defendant Sutherlin Plywood Corporation to plaintiff upon its account assigned by Oregon Plywood Corporation the sum of \$3,924.78 computed as follows:

## O.P.C. Account With Sutherlin

Veneer purchases for Sutherlin		
(Net after C/D)	\$214,346.87	
Mortgage Note Receivable—12/16/53	50,000.00	
Mortgage Addition—3/1/54	30,000.00	
Interest on Mortgage Note to		
10/15/54	2,335.01	
Veneer Deductions		\$162,883.36
Veneer Deduction Letter 3/15/54		6,637.31
Direct Remittance—Pacific Ply. 7/28/54		2,364.40
Assignment—Multi-Plyd. Car 162737		4,995.28
Western Door & Ply.		804.36
Coastal Lumber, Inc.		205.00
Mortgage Principal Payments—2/24/54		1,000.00
Mortgage Principal Payments 5/17/54		2,000.00
Mortgage Principal Payments 11/25/54		77,000.00
Mortgage Interest Payment—11/25/54		2,335.01
	<hr/>	<hr/>
	\$296,681.88	\$260,224.72
Balance due O.P.C.		\$ 36,457.16

O.P.S.C. Account With Sutherlin

Credit Memos on final settlements	\$ 32,754.79	
	182.53	
	482.26	
	<hr/>	\$ 33,419.58
Credit Frt. on Gov. cars		1,642.97
Credit Additional Adj.		1,870.91
Loss on cars accepted but not shipped by Sutherlin	1,526.80	
Expenses Car 66555—Letter 9/10/54	336.00	
Bal. due Assignment 4/5/54	2,538.28	
	<hr/>	<hr/>
	\$ 4,401.08	36,933.46
		4,401.08
		<hr/>
Balance due Sutherlin		\$ 32,532.38
Balance due O.P.C.	\$36,457.16	
Balance due Sutherlin	32,532.38	
	<hr/>	<hr/>
Balance due		\$ 3,924.78

XXX.

Defendant Sutherlin Plywood Corporation failed to prove its counterclaim and there is nothing due and owing by plaintiff to defendant Sutherlin Plywood Corporation.

Conclusions of Law

I.

This court has jurisdiction of the parties to and the subject matter of this action.

II.

By executing the agreements referred to in paragraph V of the Finding of Fact, defendant Sutherlin Plywood Corporation agreed to sell and ship to plaintiff up to 80 per cent of its actual production of plywood on orders furnished by plaintiff, but did not agree or promise to continue production of

plywood for any period of time, and in the event conditions made it unprofitable to continue or it was prevented from continuing in production it was to be relieved from furnishing any further production of plywood to plaintiff and from honoring further orders of plaintiff.

### III.

By executing the agreements referred to in paragraph V of the Finding of Fact, defendant Sutherlin Plywood Corporation did not divest itself of the right to or agree not to dispose of its physical assets in the event it should determine to do so in good faith and in the exercise of honest business judgment or in the event conditions made it unprofitable to continue or it was prevented from continuing the production of plywood.

### IV.

Plaintiff has failed to sustain the burden of proving that, prior to or at the time of the execution of said agreements, defendant Sutherlin Plywood Corporation guaranteed, promised or represented to plaintiff in any that defendant Sutherlin Plywood Corporation would continue in operation for at least 50 months or for any other period of time.

### V.

Plaintiff has failed to sustain the burden of proving that defendant Sutherlin Plywood Corporation acted in bad faith in ceasing operations or selling its mill.

### VI.

Defendant Sutherlin Plywood Corporation did

not breach said agreements by terminating production of plywood or by selling its physical assets, including said mill, to defendant Nordic Plywood, Inc., or by failing to furnish to plaintiff 80 per cent of the output of said mill after defendant Nordic Plywood, Inc., commenced operating it.

## VII.

Defendant Sutherlin Plywood Corporation was excused from furnishing plaintiff with further production of plywood and from honoring further orders of plaintiff by reason of its financial losses, insolvency and inability to produce further.

## VIII.

Plaintiff failed to sustain the burden of proving that defendant Nordic Plywood, Inc., interfered with said agreements or induced a breach thereof or conspired with defendant Sutherlin Plywood Corporation to destroy plaintiff's rights therein.

## IX.

Defendant Nordic Plywood, Inc., did not unlawfully interfere with said agreements or induce a breach thereof or conspire with defendant Sutherlin Plywood Corporation to destroy plaintiff's rights therein and was not bound by them. It was privileged to purchase the physical assets of defendant Sutherlin Plywood Corporation.

## X.

[Struck Out]



## XI.

Plaintiff is entitled to no affirmative relief or damages against defendant Sutherlin Plywood Corporation for said alleged breach of contract.

## XII.

Plaintiff is entitled to no affirmative relief or damages against defendant Nordic Plywood, Inc.

## XIII.

There is due and owing to plaintiff by defendant Sutherlin Plywood Corporation the sum of \$3,924.78 and plaintiff is entitled to judgment against defendant Sutherlin Plywood Corporation in that amount.

## XIV.

Defendant Sutherlin Plywood Corporation failed to prove its counterclaim, there is nothing due defendant Sutherlin Plywood Corporation by plaintiff and said defendant's counterclaim should be dismissed.

## XV.

Neither plaintiff one the one hand nor defendants Sutherlin Plywood Corporation and Nordic Plywood, Inc., on the other are entitled to judgment against the other for their costs and disbursements incurred in this action.

Dated this 7th day of May, 1956.

/s/ GUS J. SOLOMON

Judge

Acknowledgment of Service Attached.

[Endorsed]: Filed May 7, 1956.

The United States District Court  
For The District of Oregon

Civil No. 7754

OREGON PLYWOOD SALES CORPORATION,  
a corporation, Plaintiff,

v.

SUTHERLIN PLYWOOD CORPORATION, a  
corporation, and NORDIC PLYWOOD, INC.,  
a corporation, Defendants.

JUDGMENT AND DECREE

The above-entitled-and-numbered action came on regularly for pretrial conference and trial on March 27, 1956, before the Honorable Gus J. Solomon, judge of the above-entitled court. Plaintiff appeared by and through Herbert H. Anderson, one of its attorneys, and defendants appeared by and through Fredric A. Yerke, Jr., George A. Luoma, and Mark C. McClanahan, of their attorneys. The court having heard and considered all the evidence and statements of counsel, having examined briefs of the parties, and having carefully considered all the issues of fact, and defendants having submitted findings of fact and conclusions of law, and copies of such findings of fact and conclusions of law having been served upon the attorneys for plaintiff, and such findings of fact and conclusions of law having now been filed, the court being fully advised in the premises, it is hereby

Considered, ordered and decreed that plaintiff

have judgment against defendant Sutherlin Plywood Corporation in the sum of \$3,924.78 on plaintiff's claim for balance on open account, and that plaintiff have execution therefor, and it is further

Considered, ordered and decreed that defendant Sutherlin Plywood Corporation's counterclaim for the balance on open account be dismissed, and that it take nothing thereby, and it is further

Considered, ordered and decreed that plaintiff's claims for injunctive relief and damages for breach of contract as against defendant Sutherlin Plywood Corporation and for interference with and inducement of breach of contract as against defendant Nordic Plywood, Inc., be and the same hereby are dismissed, and that plaintiff take nothing thereby.

Dated this 7th day of May, 1956.

/s/ GUS J. SOLOMON

Judge

[Endorsed]: Filed May 7, 1956.

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[Title of District Court and Cause.]

### NOTICE OF APPEAL

Notice is hereby given that Oregon Plywood Sales Corporation, plaintiff above named, appeals to the Court of Appeals for the Ninth Circuit from so much of the judgment entered in this action on May 6, 1956 as disallows plaintiff's claim for injunctive relief and damages for breach of contract against defendant Sutherlin Plywood Corporation and for damages and punitive damages for interfer-

ence with and inducement of breach of contract against defendant Nordic Plywood, Inc.

Dated June 5, 1956.

KOERNER, YOUNG, McCOLLOCH  
& DEZENDORF

/s/ HERBERT H. ANDERSON,  
Attorneys for Plaintiff.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed June 6, 1956.

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[Title of District Court and Cause.]

### CERTIFICATE OF CLERK

United States of America,  
District of Oregon—ss.

I, R. DeMott, Clerk of the United States District Court for the District of Oregon, do hereby certify that the foregoing documents consisting of complaint, answer and counterclaim of Sutherlin Plywood, answer of Nordic Plywood, reply to counterclaim of Sutherlin Plywood, answers to additional interrogatories of Nordic Plywood, supplemental answers to additional interrogatories of Nordic Plywood, pre-trial order, findings of fact and conclusions of law, judgment and decree, notice of appeal, bond for costs on appeal, statement of points, designation of record, defendants' supplemental designation, additional designation, order extending time to file and docket record, and transcript of docket entries, constitute the record on appeal

from a judgment of said court in a cause therein numbered Civil 7754, in which Oregon Plywood Sales Corporation, a corporation, is plaintiff and appellant, and the Sutherlin Plywood Corporation, a corporation, and Nordic Plywood, Inc., a corporation, are defendants and appellees; that the said record has been prepared by me in accordance with the designations of contents of record on appeal filed by both appellant and appellees, and in accordance with the rules of this court.

I further certify that the transcript of testimony will be mailed when filed, and that the exhibits will be shipped later by the appellant.

I further certify that the cost of filing the notice of appeal, \$5.00, has been paid by the appellant.

In testimony whereof, I have hereunto set my hand and affixed the seal of said court in **Portland**, in said District, this August 30, 1956.

[Seal]

R. DeMOTT,  
Clerk,

/s/ By F. L. BUCK,  
Chief Deputy.



United States District Court  
District of Oregon

Civil No. 7754

OREGON PLYWOOD SALES CORPORATION,  
a corporation, Plaintiff,

vs.

SUTHERLIN PLYWOOD CORPORATION, a  
corporation, and NORDIC PLYWOOD, INC.,  
a corporation, Defendants.

TRANSCRIPT OF PROCEEDINGS

Portland, Oregon, Tuesday, March 27, 1956,  
3:15 P.M.

Before: Honorable Gus J. Solomon, District  
Judge.

Appearances: Mr. Herbert H. Anderson, of At-  
torneys for Plaintiff; Messrs. Fredric A. Yerke,  
Jr., and Mark C. McClanahan, of Attorneys for  
Defendants.

Court Reporter: Gordon R. Griffiths. [1]\*

ROBERT HOFHEINS

a witness produced in behalf of plaintiff, having  
been first duly sworn, was examined and testified  
as follows:

Direct Examination

Q. (By Mr. Anderson): Mr. Hofheins, are you  
connected with the plaintiff? A. I am.

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\* Page numbers appearing at top of page of original Reporter's  
Transcript of Record.

(Testimony of Robert Hofheins.)

Q. What is your capacity in regard to the plaintiff? A. I am secretary-treasurer.

Q. When did you first become aware—when did you contact Sutherlin Plywood Corporation?

A. I first contacted Sutherlin Plywood Corporation in, oh, November of 1953. I was going through Sutherlin, and we had word that they were building a new mill there that might be completed rather soon so I stopped in at their office to see if they had any plywood available for sale.

Q. What occurred at the meeting in November, 1953, at Sutherlin?

A. Well, I went into their office, and I had—I met one or two of the people that were around there, and I had a little discussion with them and indicated that I was interested in plywood sales. They indicated that they had their plant about ready for operation but that they were handicapped because of the lack of working capital. I indicated to them that we might be able to help them obtain some working capital, and at [15] that time it was arranged that they would send some people up to Sweet Home up to my office up there to talk further about the matter.

Q. Did the Sweet Home meeting take place?

A. It did.

Q. What happened at the meeting in Sweet Home?

A. Well, there was several representatives of Sutherlin Plywood came up to Sweet Home, and we had a little meeting in my office there, and we

(Testimony of Robert Hofheins.)

discussed in a general way their need of some working capital and our need of some material for sale, and we talked about the situation in more or less of a general way. I indicated that I thought I could get them the money that they needed, and they were very much interested in it.

At that time it was indicated that their plant was about ready to go into operation and that they planned on producing plywood and continuing to produce plywood, and we worked out roughly the basic points in the contract that were eventually involved.

Q. You say they planned on producing plywood?

A. That's right.

Q. Did they specifically advise you that they intended to continue operations? A. They did.

Mr. Yerke: Just a minute. We object to that as incompetent. [16] Anything that is going to be stated here, relied upon as part of the agreement, would relate to the agreement finally drawn up between the parties, and we object to any testimony concerning any discussion or any testimony concerning the details of a proposed agreement under the parol evidence rule. These discussions, if anything, would have been merged in the ultimate agreement which was signed December 17, 1953. We think this is important, your Honor, because we believe the witness is attempting at this time to lay the basis for testimony that there was a representation or that there was an agreement that there would be continuous productions and the agreement

(Testimony of Robert Hofheins.)

as finally drafted is in terms of output, and any testimony concerning an agreement for continuous production, under the parol evidence rule, would be inadmissible in view of the use of any of that wording in the agreement.

The Court: What have you got to say about that?

Mr. Anderson: I say that this does not apply to this situation, your Honor. There is authority that in this type of situation where we are trying to determine what the parties meant by "output" and whether or not they intended to continue production, that the representations made at the meetings are material and should be admitted.

The Court: But you first have to determine whether the contract is ambiguous. You cannot use parol evidence to create an ambiguity and then introduce parol evidence to explain that. [17] Let's see the contract and we will see if the contract is ambiguous.

Mr. Anderson: We contend, your Honor, that it specifically provides that they will produce.

The Court: Well then, you do not need this oral testimony.

Mr. Yerke: The rule on this point we have cited, your Honor, on page 13 of the memorandum we have handed to the Court. That is the parol evidence rule with respect to an output contract.

Mr. Anderson: There is a United States Supreme Court decision that says in this type of case the representations of parties are material in regard to the output, your Honor.

(Testimony of Robert Hofheins.)

Now, there are two points we contend; first, that the contract expressly requires them to continue production, and, secondly, if it should not be understood that the contract so provides, that there is an implied obligation, that in regard to this second point there is certainly an ample reason to admit this evidence.

The Court: What is your Supreme Court case?

Mr. Anderson: I do not have it here. I will have to look it up during the recess, your Honor. I do have the point in mind.

The Court: I will overrule this testimony until you have found the case. On your first point, Mr. Anderson, obviously you would not need this testimony. [18]

Mr. Anderson: At this time the Court so rules we will not need it?

The Court: Yes.

Mr. Anderson: The decision is in the first paragraph on page 3, about the middle of the page, about continuing production.

The Court: I think this would be a propitious time to consider exhibits. Mr. Anderson, I see your exhibits are marked 1 to 13, other than the depositions.

Mr. Anderson: We have set up, your Honor, some additional ones through to 28.

The Court: Are the depositions taken for discovery, or are they de bene esse depositions?

Mr. Anderson: Well, I think most of the wit-



(Testimony of Robert Hofheins.)

nesses are here and will testify, but it may be that——

The Court: Are you offering 1 to 13, inclusive, and 23 to 28, inclusive?

Mr. Anderson: Yes, your Honor. Well now, I beg your pardon, I have some doubts about the letters, that is, 7 and 8.

The Court: All right, exclude from that 7 and 8. All others are offered? Mr. Yerke, to which of the exhibits do you object?

Mr. Yerke: We will not object to the admission of Exhibits 1 to 6, inclusive. The statement of account, Exhibit 9, we will not object to that as far as any requiring any foundation [19] to be laid, but we are not conceding the accuracy of the statements contained therein.

The Court: Very well.

Mr. Yerke: On Exhibit 10, I don't know just how much of this correspondence he intends to put in. We intend to put in some of it, but it is a loose term, of course, as used there.

The orders which are Exhibit Number 11, we have no objection to them.

The Court: What about 12 and 13?

Mr. Yerke: We have no objection to the admission of Exhibit 13. We would like to reserve Number 12 for the time being.

On the depositions, they were all taken by plaintiff.

The Court: We are not worrying about the depositions now. How about 23 to 28? I am going to

(Testimony of Robert Hofheins.)

rule now that 1 to 6 are admitted and 9, 10, 11, and 13 are admitted.

(Thereupon, the documents previously identified as Plaintiff's Exhibits 1 to 6, both inclusive, and 9, 10, 11, and 13 were thereupon received in evidence.)

Mr. Anderson: May I say, your Honor, Number 9 has been supplemented by a later statement which is Number 24 and is actually out of date.

The Court: Do you want to withdraw Number 9?

Mr. Anderson: Yes, I want to withdraw Number 9 and substitute Number 24.

The Court: All right, 9 is not included.

(Thereupon, document previously identified and received as Plaintiff's Exhibit Number 9 was withdrawn.)

The Court: Mr. Yerke, did you see 23 to 28?

Mr. Yerke: We have no objection to 23, your Honor.

The Court: 24 you have not any objection to either?

Mr. Yerke: We do object to 24. We do not concede the accuracy in any way of it, and we question whether or not the underlying data is present here as far as that is concerned.

The Court: Do you have an accountant who will testify?

Mr. Anderson: We have the secretary-treasurer of the corporation, Mr. Hofheins, your Honor, who will testify to the summary of the open account.

The Court: I am not going to admit 24 now. Let the witness testify as to it.

Mr. Yerke: We have not seen Exhibit 25, the calls made by plaintiff, I don't know what that refers to. The barometer reference, of course, would be brought out by the Douglas Fir Plywood Association at Tacoma. We question the relevancy and materiality of the same. We will not object as far as the competency is concerned. As to Exhibit 28, our position is the same. [21]

The Court: I am not going to pass upon 23 to 28 at this time. Proceed.

Where did you tell me to look on that contract, page 1?

Mr. Anderson: Paragraph one provides that Sutherlin will accept and ship orders up to 80 per cent of the production, and on page 3 it provides that the contract will continue in effect for 50 months.

The Court: You say that that implies that Sutherlin will be in continuous operation during all of that period?

Mr. Anderson: I say that it both implies and expressly promises.

The Court: I know your point.

Mr. Anderson: I have another question which is along the same line. Perhaps the Court would prefer to defer that. That is in regard to shutdown, in regard to what discussions were had in regard to shutdown of the plant.

The Court: Give me that Supreme Court decision. This Court is bound by the Supreme Court.

(Testimony of Robert Hofheins.)

Mr. Anderson: Thank you.

(Thereupon, the direct examination of Mr. Hofheins was continued as follows):

Q. (By Mr. Anderson): What was the approximate date of the Sweet Home meeting?

A. Oh, I don't remember exactly, but it was in November or [22] December, 1953.

Q. Was that followed by further meetings between the parties? A. It was.

Q. What happened next?

A. Well, next we had a meeting in Eugene at the Eugene Hotel.

Q. What transpired at the Eugene meeting?

A. Well, at the Eugene meeting there were practically all of the board of directors and officers of the Sutherlin Plywood there, and we met in one of the rooms of the hotel which had a long table with a lot of chairs around it, and we all sat around the table, and we had—we discussed these questions of the contracts and our procuring the money for them, and at that time the contracts were finally drawn up in their final state, and they were signed, and I gave Sutherlin a check for \$50,000 for the first moneys.

Q. Were the contracts all one instrument or several?

A. No, there were two contracts drawn. Mr. Hoffman typed up two contracts, as I recall it. One was between Oregon Plywood Corporation and Sutherlin Plywood Corporation, and that was in connection with the mortgage and the additional

(Testimony of Robert Hofheins.)

\$30,000 if they needed it, and it also covered the matter of the payment for the veneer which they were going to use. Then there was a second contract which Mr. Hoffman typed up, and that was between Oregon Plywood Sales Corporation and Sutherlin Plywood Corporation, and that covered the selling of 80 per cent [23] of the output of Sutherlin Plywood and also covered the matter of the advance against their receivables.

Mr. Anderson: I would like to suggest, your Honor, that we would like to put in this evidence in its chronological relation, and we have charged in one of our contentions that the defendant, Sutherlin, did represent that it would produce continually, and we charge them with bad faith. I believe that aside from this other point that we should be entitled to put this evidence in under that contention, and, if possible, I would like to put it in its chronological order. I believe it could go in under that contention. It is contention nine, I believe, your Honor.

The Court: Who prepared this contract, who drafted this contract?

The Witness: The final draft of the contract was by Mr. Louis Hoffman who was attorney for Sutherlin Plywood.

Mr. Yerke: We will take issue with that, of course, your Honor. Our contention, of course, is that the witness prepared it.

The Witness: The contract was actually typed by Mr. Hoffman, I believe.



(Testimony of Robert Hofheins.)

The Court: Are you a lawyer?

The Witness: No, I am not.

The Court: I have never heard of Hoffman.

Mr. Anderson: A Eugene attorney, your Honor.

The Witness: He has an office on the main street down there on the second floor, and I remember quite vividly because I offered to do some of the typing for him, and he said he thought he could work it out himself.

The Court: What do you say about that, Mr. Yerke? On the question of fraud, don't you think that representations are admissible?

Mr. Yerke: They are not claiming fraud, your Honor. They are claiming that there was breach of contract by the defendant Sutherlin Plywood Corporation, and they are trying now to build in an obligation which, in fact, was not existence at any time and which actually is in conflict with the particular provision of the agreement previously referred to, and that is the word "output."

There is an annotation in 1 A.L.R. on this particular point. There it is stated the term output, which is what we are concerned with here, means a quantity of material put out or produced within a stated time. There is no occasion to refer to remembrance of facts and circumstances to explain any ambiguity therein. The only purpose of such reference would be to import into the contract an additional provision as to the quantity and this is true notwithstanding that in addition to the use of the term "output" the parties have included in the

(Testimony of Robert Hofheins.)

contract an estimate as to the amount of such output since such output is not stated as a reality. [25]

The Court: I am going to sustain the objection unless the testimony will not take very long.

Mr. Anderson: Just one question, your Honor.

The Court: Let it go in, and I will sustain the objection. I might tell you that as of this time I think I would place no credence in this statement unless you have some authority to support it.

Q. (By Mr. Anderson): Mr. Hofheins, what was represented to you during the discussion at Sweet Home and Eugene by the officers of Sutherland Plywood Corporation concerning continuing production?

A. They had the plant about ready to go, and they needed the money. As soon as they got money they would get into production and continue to produce plywood.

Q. What was represented concerning the length of time?

Mr. Yerke: Same objection, of course, your Honor.

The Court: Go ahead.

The Witness: That it would be at least during the duration of the contract.

Q. (By Mr. Anderson): For what period?

Mr. Yerke: The contract speaks for itself. We would object to leading the witness.

The Court: That is 50 months. Actually, Mr. Hofheins, they hoped to operate ten years, didn't they?

(Testimony of Robert Hofheins.)

The Witness: Or longer, your Honor; yes, sir.

The Court: Yes, everybody that goes into business hopes [26] that they are going to make money and operate.

Q. (By Mr. Anderson): Now, Mr. Hofheins, what action did Oregon Plywood Sales Corporation take after this contract was executed?

A. Well, we immediately started to obtain orders for Sutherlin, and we continued that effort, and we made an announcement to the trade, and we set out, we started ads in the trade paper journals such as the *Timberman* and the *American Lumberman*. We contacted some of our old accounts personally by mail, by telephone. We put on extra help in the office. We did all those things that you would visualize that you would normally do to do a selling job.

The Court: Is there any contention that the plaintiff was reluctant?

Mr. Yerke: We will not contend that the plaintiff failed to furnish orders. The contract, however, provides that the plaintiff would use its best efforts to maintain a 30-day supply of orders. We will contend that that was not fulfilled to the extent it was enforceable and——

The Court: What was the capacity of the plant?

Mr. Anderson: It is represented to be two and a half million at the the time these parties were engaged in this contract.

Mr. Yerke: Our position would be that it is

(Testimony of Robert Hofheins.)

about two million square feet per month; not two and a half. [27]

Mr. Anderson: Two to two and a half. Their manager stated two and a half.

Q. Mr. Hofheins, prior to the time you made the contract with Sutherlin had you been looking for another source of plywood? A. We had.

Mr. Yerke: Objected to as irrelevant, immaterial.

The Court: Yes, but he has already answered it.

Q. (By Mr. Anderson): Mr. Hofheins, after the contract with Sutherlin was made what efforts, if any, did you make in connection with other sources of plywood?

A. Well, immediately after the contract was made we devoted all our efforts to the Sutherlin agreement and stopped looking for an additional contract type of source.

Q. Mr. Hofheins, did the parties enter into operation and performance of this contract?

A. I didn't get the question.

Q. Did the parties enter the performance of this contract?

A. Yes, they did. Along after we had supplied Sutherlin with the orders that they requested, why, along in January they began to produce and started to ship, and they shipped from then until, well, they ran until late April, and they had some stock on the floor after they shut down, some cats-and-dogs, odds and ends, and we even cleaned those up for

(Testimony of Robert Hofheins.)

them. That was in May, I think, the last shipments came out. [28]

Q. Did the plaintiff advance the loan which it had promised? A. Yes.

Q. Or obtain an advancement of the loan?

A. It did.

Q. That was in what amount?

A. Well, eventually we advanced \$80,000 or got the advance of \$80,000 for them.

Q. Did the plaintiff make advances for the purchase of green veneer as it had promised?

A. It obtained the advances of green veneer up to, oh, around 215, 216 thousand dollars; yes, sir.

Q. Did the plaintiff make advances on invoices to Sutherlin?

A. It did in excess of, oh, \$160,000.

Q. Did the plaintiff use its best efforts to maintain a 30-day order file at Sutherlin?

A. Yes, sir.

Q. Did the plaintiff take from Sutherlin 80 per cent of its production?

A. It took—based on the information I have, it took more than 80 per cent.

Q. Did the plaintiff offer to defendant further financing in connection with the purchase of green veneer early in the spring of 1954? A. It did.

Q. What was the nature of that offer? [29]

A. Well, there was some rumors that there would be a strike in the industry. Mr. Franklin Hofheins got in touch with Mr. Patterson and ad-



(Testimony of Robert Hofheins.)

vised him of the rumors which we had heard and indicated to him——

The Court: Well, I think you cannot testify as to that.

The Witness: I was there when it happened.

The Court: Were you there?

The Witness: I was there in his office.

The Court: What month was that?

The Witness: That was, I think, in April.

Mr. Anderson: There is a letter in the correspondence file, your Honor—I think it is actually February—in which the letter suggested they line up suppliers for green veneer to supply veneer or something to that effect.

The Court: Go ahead with the testimony.

Mr. Anderson: I might say that this is over and above the terms of the contract, and I am just simply mentioning it as one of the additional things that the plaintiff did.

The Witness: Yes, they got in touch with Mr. Patterson and advised him of the rumors that we had had and suggested that it might be advantageous if they would put in additional green veneer which we, of course—which Oregon Plywood Corporation would finance for them so they would have a stock pile if the strike came along.

Q. How long did defendant Sutherlin operate?

Mr. Yerke: That is covered by agreed facts, Mr. Anderson.

The Witness: Three and a half months.

Q. (By Mr. Anderson): What did plaintiff do

(Testimony of Robert Hofheins.)

when it was notified that defendant Sutherlin would produce no more plywood?

A. Well, there was a—they verbally objected to it on several occasion. Then there was a letter written in May and another one in August.

Q. Did the plaintiff attempt to obtain plywood elsewhere? A. It did.

Q. What efforts were made in that connection?

A. Well, there were contacts made with a great many other mills by telephone, telegraph, and by personal contact by several parties from our organization, and they were unable to procure any plywood on any kind of a similar arrangement or at a similar price basis.

Mr. Anderson: To save time, your Honor, I may say that within the pleading filed are interrogatories several pages in length reciting the efforts made to obtain plywood elsewhere. I do not think it is necessary to put in any further evidence on that.

The Court: Very well.

Q. (By Mr. Anderson): Mr. Hofheins, what occurred——

Mr. Yerke: Your Honor, we are reserving all objection to this except with respect to attempts made by Norman Pritchard, a log buyer employed by Oregon Plywood Corporation. We took [31] his deposition. We have no objection to that portion of the interrogatories going into the evidence. However, on the remainder we have not had any

(Testimony of Robert Hofheins.)

opportunity to cross examine. The people concerned are back in Buffalo, New York.

Mr. Anderson: Mr. Thompson who made a number of those will be here, your Honor, and defendants will have an opportunity to cross examine him.

Q. Now, Mr. Hofheins, what occurred in the plywood industry in June of 1954?

A. There was a general strike in the industry.

Q. What happened to the plywood market at that time?

A. The market immediately became stronger and prices went up, and unfilled order files went up. The price went from \$76 in June of 1954 up to \$90 or better in September of 1954, August and September, and then that fall, as I recall, why, the unfilled order file was up the highest in the history of the industry.

Q. When you speak of price, to what grade are you referring?

A. Quarter-inch A.D. which is the base diameter used.

Q. That is called the index rating in the industry; is it not?      A. That's right.

Q. Did you attend a directors' meeting of Sutherlin Plywood Corporation in July, 1954?

A. I did.

Q. What was discussed at that meeting? [32]

A. Well, there was a resolution which had been prepared which was presented to the meeting about the sale or lease of Sutherlin plant.

(Testimony of Robert Hofheins.)

Q. Was your opinion asked as to whether or not the plaintiff would approve a lease of the mill?

A. Yes, sir, and I stated that they would be opposed providing that we did not get the output.

The Court: On the lease?

The Witness: On the sale.

Mr. Yerke: That is what he testified to.

The Witness: On the sales.

The Court: Also on the sale?

The Witness: On the sales; yes, sir.

The Court: Where are the minutes of the meeting?

Mr. Yerke: We intend to offer them in evidence, your Honor. We have them.

The Court: Have they been exhibited to Mr. Anderson?

Mr. Anderson: I believe I saw the minutes in Roseburg, and I assume that they were all in the minute book at that time.

Mr. Yerke: That is correct; they were.

The Court: Do they show objection by Mr. Hofheins?

Mr. Yerke: No, your Honor, they show that the motion was made and seconded and carried. They show no objection. They do not show how he voted.

Mr. Anderson: I think that is correct. They [33] do not cover this point, your Honor.

Q. Mr. Hofheins, at the directors' meeting in July, what was primarily discussed, the lease or sale?

A. Well, I got the impression that it was primar-

(Testimony of Robert Hofheins.)

ily a sale. That was the basic discussion. I know I was presented with what was purported to be a financial statement, and about that time everybody was talking about selling the plant.

Q. In July had the market started to rise?

A. It had.

Q. What was the price in July?

A. Oh, I would say the price in July was right around \$85. That is probably a fair average.

Q. When did you first hear of the sale to Nordic?

A. When it was actually sold?

Q. When did you first hear of the sale?

A. Oh, in the fall. I would say in September, October some time.

Q. Did you hear of it before the sale was actually consummated?

A. No, sir.

Q. What has been the status of the plywood market from June, 1954, to the present?

A. It has been strong.

Q. What had been the prices?

A. All during 1955 the price was about \$85 with sometimes sheathing being a little bit higher, than that basis, and about the first of the year, this year, why, it went to \$88 to \$90. [34]

Q. Have you submitted orders to defendant Nordic Plywood, Incorporated?

A. Yes, sir.

Q. When were those orders submitted?

The Court: Well, I don't think you ought to go into that. Nordic states they won't accept any of those orders.

Q. (By Mr. Anderson): Mr. Hofheins, was the



(Testimony of Robert Hofheins.)

contract that you had with Sutherlin Plywood Corporation profitable to the plaintiff?

A. Yes, sir.

Q. Mr. Hofheins, have you suffered damages in regard to the alleged breach of this contract?

A. We have.

Q. Concerning the period from April 15, 1954, to September 15th when Nordic started operating the mill, a five-month period, what production should Sutherlin have delivered to you?

Mr. Yerke: Objected to as incompetent. The witness is not qualified to answer that; no foundation laid for the same either.

The Court: Ask him what orders he had. I think that is the situation. I would be interested in knowing what orders they got that they could have submitted.

Q. (By Mr. Anderson): Mr. Hofheins, during the period April 15th to September 15, 1954, did you have orders for which you could have used plywood from defendant Sutherlin? [35]

A. Yes, sir.

Q. Could you tell us the amount of the orders that you had?

A. Well, I would say that roughly in May and June we could have submitted, oh, not less than a hundred thousand dollars a month to them for those two months, and then beginning in June with your strike, why, we could have submitted substantially more than they would have been able to produce on the basis of their equipment.

(Testimony of Robert Hofheins.)

The Court: May and June?

The Witness: It would run over \$200,000 a month.

The Court: You mean in July and August?

The Witness: Yes; that's right.

The Court: If there was a strike in the industry, how could they have been producing if they depend upon their veneer from someone else?

The Witness: Well, not all of the veneer mills, Judge, are union.

The Court: Was this a union plant?

The Witness: No, sir.

Q. (By Mr. Anderson): Mr. Hofheins, are you familiar with the production of the mill when Sutherlin was operating it?

A. I am familiar in a general way with the figures that they submitted to me, yes, sir.

Q. Those are agreed upon. For the Court's information I will state that they range from approximately a million in [36] January, approximately a million in February, a million and a half in March, 481,000 in April.

The Court: Are you talking about the production up to April?

Mr. Anderson: Yes, your Honor.

The Court: It is stipulated in the pre-trial order.

Mr. Anderson: Yes, I just mentioned that.

Q. Now, Mr. Hofheins, could you have produced orders for 80 per cent of the same production after Sutherlin shut down?      A. Yes, sir.

(Testimony of Robert Hofheins.)

Q. What profit would you have made out of this sales contract?

A. Well, we would have made during that period, we would have made not less than \$500,000 a month on that basis.

Mr. Yerke: Just a minute, what did you say?

The Witness: Not less than \$5,000 a month on the basis of production which they at that time had, and the fact that their mill was new and the fact that their mill was capable of larger production, and the figures indicated that it was working in the latter productions.

Mr. Yerke: We move to strike all this testimony on the ground of no foundation laid. The witness is not qualified. The testimony is incompetent.

The Court: No foundation has been laid. I thought you were going to submit orders that the Oregon Plywood Sales Corporation received during this period. Don't you have those orders? [37]

Mr. Anderson: I don't know whether we have the orders here, your Honor. Here is a witness who testified that they could have taken the 80 per cent, and they had sales for it. They did submit orders to Sutherlin, and they were rejected.

The Court: I thought that that was what either you or someone else who came before me said some six or eight months ago in some interrogatories. Wasn't that price question involved at that time?

Mr. Yerke: Those, I think, your Honor, were the invoices from Sutherlin to Oregon Plywood Sales Corporation together with the orders from

(Testimony of Robert Hofheins.)

Oregon Plywood Sales Corporation to Sutherlin. The witness now, of course, is attempting to testify as to what might or might not happen under a variety of circumstances, and I believe the question is pointed to the orders which Oregon Plywood Sales Corporation would have had from its customers which it in turn would have turned around presumably and have forwarded to the mill. We have not inspected such documents. They have not been listed in the pre-trial exhibits by the plaintiff.

Mr. Anderson: Well, now, that would be corroborated——

The Court: How can your man testify as to what orders he would have gotten during that period?

Mr. Anderson: They had the orders, your Honor. We can obtain the written orders, the corroboration of his statement, [38] but he testifies that they had the orders. That is the testimony we are producing at this time, and that they were unable to fill those orders because they were not getting the 80 per cent of output of this mill.

Mr. Yerke: But you are going also to have to establish, Mr. Anderson, in view of the provisions of your contract that the orders would also have been profitable to Sutherlin Plywood Corporation because Sutherlin under the provisions of your contract had the right to refuse any orders which were unprofitable.

Mr. Anderson: Well, that point——

The Court: I am going to let the evidence in. I think that we will get along faster if we let most



(Testimony of Robert Hofheins.)

of the evidence in, but let me admonish you, Mr. Anderson and Mr. Yerke, do not go too far.

Q. (By Mr. Anderson): Mr. Hofheins, when you say that you would have made \$5,000 a month during this five-month period, what do you base that upon? A. On 5 per cent of a thousand dollars.

Q. Would you have had expenses in connection with handling that hundred thousand dollars worth of sales? A. Yes, sir.

Q. What would those have been per month?

A. Oh, I would say in the neighborhood of seven hundred fifty to a thousand dollars a month.

Q. So that would leave a loss of how much [39] per month when you did not get the production?

A. Between \$4,250 and \$4,000.

Q. Do you know whether or not the mill has been operated since September 15, 1954, to the present? A. I understand that it has been.

Q. Have you seen the production records of the mill? A. I have.

The Court: They are all stipulated.

Mr. Anderson: They are here, your Honor.

The Court: In paragraph 13.

Q. (By Mr. Anderson): It is agreed that the production of Nordic has been on an average in excess of 2,000,000 feet per month since September 15th. What would have been your profit had you received 80 per cent of the production?

Mr. Yerke: We do put in an objection to that, your Honor, on the grounds there has been no establishment of a similarity of circumstances with respect to the two operations, and, in fact, the phy-



(Testimony of Robert Hofheins.)

sical circumstances are vastly different, which counsel well knows.

The Court: What do you mean, "physical circumstances"?

Mr. Yerke: The plant has been remodeled. There is additional equipment in, and some shortcomings which originally contributed to the losses which were sustained and the low production during the shake-down period have been eliminated. In addition there has been a vast amount of equipment [40] put in there.

Mr. Anderson: I think that goes to the weight of it, your Honor. All we are asking now is as to what would have been the profit had they received 80 per cent of 2,000,000 feet per month which has been produced.

The Court: He may answer the question.

The Witness: May I have the question again, please?

Mr. Anderson: Perhaps I had better restate it.

Q. What would have been plaintiff's profit had you received 80 per cent of the production produced in the mill after September 15, 1954?

A. Well, based on its actual production it would, of course, have been 5 per cent of the mill——

The Court: That is \$10,000 a month, and it would cost you about \$2,000 a month to operate so you would have about \$8,000 a month profit.

The Witness: Thank you, sir.

The Court: All right, go ahead.

Q. (By Mr. Anderson): Mr. Hofheins, do you have an open account claim in this lawsuit?

(Testimony of Robert Hofheins.)

A. We do. [41]

(Document, Summary of plaintiff's open account claim, marked Plaintiff's Exhibit 24 for identification.)

(Document, Assignment of open account claim by Oregon Plywood Corporation to plaintiff, marked Plaintiff's Exhibit 25 for identification.)

Q. (By Mr. Anderson): Mr. Hofheins, what is the document handed to you marked Exhibit 24?

A. This is a summary of the cardinal points of our balance-due claim against Sutherlin Plywood.

Q. Mr. Hofheins, who prepared this summary?

A. I prepared this summary.

Q. What is the amount which is shown owed by Sutherlin according to this summary?

Mr. Yerke: Objected to as incompetent, no foundation has been laid for the same. The foundation documents have not been brought in, and the witness' competency has not been demonstrated.

The Court: Do you have the documents here?

Mr. Anderson: I think we have the supporting data, your Honor, although it is quite voluminous. I may say for the Court's information that the defendants have a statement likewise, and it is suggested that we confer on these statements and try to reduce the items of difference to the minimum.

The Court: I think that is a very good suggestion. Obviously, there are some of these items about which there is no dispute. [42]

Mr. Yerke: That is right, your Honor. We were

(Testimony of Robert Hofheins.)

concerned about the disputed items, and that is why the objection was made.

The Court: The amount claimed is \$3,824.78; isn't that right?

Mr. Anderson: That is right.

The Court: I see one item here, "Loss on cars accepted but not shipped by Sutherlin." Is there a dispute about that item of \$1,526?

Mr. Yerke: Most of those items, your Honor, relate to the unliquidated damage claims, and we question the right of plaintiff to have asserted them in this lawsuit. The contention in question is an open account. That is what this is supposedly based on. Those are unliquidated damage claims based upon a contention of underselling to others than the plaintiff, and that contention is disputed by the defendant Sutherlin Plywood Corporation.

Mr. Anderson: Well, I think we may be able to get together on several of these items.

The Court: Why don't you do that, Mr. Anderson.

Mr. Anderson: I would like at this time to have the witness state his qualification to answer in regard to the amount due as to whether or not this comes from the books and records of the company.

The Court: Very well, go ahead. [43]

Mr. Yerke: We may have our objection, your Honor?

The Court: Yes, that is right.

Q. (By Mr. Anderson): Mr. Hofheins, have

(Testimony of Robert Hofheins.)

you prepared this from the books and records of the plaintiff?

A. I got the specific information from our book-keepers, and then I prepared the summary from that information.

Q. Those things represent the amount which is still owing from defendant Sutherlin Plywood to the plaintiff?      A. It does.

Mr. Anderson: I understand that all the exhibits except 23 to 28 are received.

The Court: Yes, do you want to introduce any of those exhibits through this witness, 23 to 28?

Mr. Anderson: Yes, your Honor.

The Court: Go ahead.

Mr. Anderson: Do you wish to have all those identified, Mr. Yerke, or may we agree that they shall all be admitted?

Mr. Yerke: I thought that we had indicated we had no objection to 23.

The Court: 23 is admitted.

(Document previously identified as Plaintiff's Exhibit 23 was thereupon received in evidence.)

Mr. Anderson: As I understand it, there were no objections to 1 through 13? [44]

The Court: Those are all admitted. We have admitted some of those already. We are only working on 24 to 28, and I am going to withhold action on 24 at this time.

Mr. Anderson: We offer 25.

(Testimony of Robert Hofheins.)

The Court: You had better show it to the witness first.

Mr. Anderson: The witness has it.

Mr. Yerke: We do not object to it. That is all right.

The Court: 25 is admitted.

(Document previously identified as Plaintiff's Exhibit 25 for identification was received in evidence.)

The Court: What about 26? Have you got 26?

The Witness: No, sir; I have.

Mr. Anderson: 26 is embraced in the interrogatories.

Mr. Yerke: We have never seen that. That is apparently an attempt to place into evidence the interrogatories that we have not had an opportunity to cross-examine anyone on except Norman Pritchard. If you want to put in that portion of the interrogatories relating to his efforts together with the deposition, we have no objection.

Mr. Anderson: We will wait until Mr. Thompson arrives.

The Court: I am going to admit 27 and 28 for what they are worth.

Mr. Anderson: I do not have 27 here, your Honor, but I do not think it will be necessary because it is embraced [45] in 28. It will be a duplication.

The Court: 27 is not admitted; 28 is.

(Exhibit 27 not submitted.)



(Testimony of Robert Hofheins.)

(Document previously identified as Plaintiff's Exhibit 28 for identification was received in evidence.)

The Court: Mr. Yerke, I think that the witness is yours.

Mr. Anderson: Yes, sir, that is correct.

Cross Examination

Q. (By Mr. Yerke): This representation that you referred to, Mr. Hofheins, that was made also at Sutherlin, was it, when you first went down to the mill?

A. No, I didn't say that, sir.

Q. It was not made at that time?

A. You mean the representation of the fact that they were going into production and continue to produce?

Q. That is what I have in mind, yes.

A. No, no, that to the best of my recollection came out in Sweet Home to begin with, that meeting there.

Q. Who made the representation to you at Sweet Home?

A. I don't recall exactly who it was. There were several members from Sutherlin, and my impression was that we talked about the whole thing, and they very definitely stated that they were going into the plywood production and would continue to produce plywood with their new mill. [46]

Q. But you do not recall the exact individual that made that representation?

A. No, that was two and a half years ago, Mr. Yerke.

(Testimony of Robert Hofheins.)

Q. There apparently was one meeting at Eugene at the Eugene Hotel; is that correct?

A. That is correct; right; yes, sir.

Q. Isn't it correct that there were two meetings?

A. I don't recall them, sir.

Q. You don't recall? A. No.

Q. Do you recall attending a meeting at the Eugene Hotel on December 6, 1953, with the members of the board of directors of Sutherlin?

A. No, the one that I recall was the one where we had the back room with the table.

Q. Do you recall after one of these meetings hurrying to meet the plane or to catch a plane at Eugene, West Coast Airlines or United Air Lines?

A. No, but that is entirely probably because I am doing that all the time.

Q. Do you recall being at a meeting in Eugene alone, that is, alone with the board of directors of Sutherlin, without any other persons that were appearing on behalf of Oregon Plywood Sales Corporation?

(Witness shakes head.) [47]

Q. Your answer is No?

A. No, that's right.

Q. The only meeting you recall then apparently is that meeting where the contracts were signed?

A. That's right.

Q. And the contracts recite that they were signed on December 17, 1953. That is your recollection of the date of the meeting?

A. That's my recollection; yes, sir.

(Testimony of Robert Hofheins.)

Q. Didn't you type out the drafts of those contracts?      A. No, sir.

Q. You do not recall doing that?

A. No, I do not.

Q. Do you recall typing out the drafts and then going down to make the corrections with Mr. Hoffman in his office?

A. I remember we went down to Mr. Hoffman's office, and we had—at the meeting we had a rough draft of what had been proposed, as I recall it, and then Mr. Hoffman took that, and as I recall it, he made changes in it and revamped it and so forth and so on, and then he went over to his office, and I recall that I went over with him.

The Court: I do not think he has to go into that any further, Mr. Yerke. This is an unusual contract, and Mr. Hofheins has indicated he is not a lawyer. Do you think he could draft a contract of this kind? [48]

Mr. Yerke: I think that he has done some work similar to that in the past. I was going to ask him about it.

Q. Let me ask you this. Did you have a lawyer with you at that meeting, a Mr. Swan?

A. Mr. Swan was with me at the meeting, yes.

Q. He was a lawyer representing Oregon Plywood Sales Corporation?

A. No, Mr. Swan was the secretary and director of Oregon.

Q. He is also secretary and director of Oregon Plywood?

(Testimony of Robert Hofheins.)

A. No, I say, he is secretary and director of Oregon Plywood Corporation.

Q. Is he an officer of Oregon Plywood Sales Corporation? A. No, sir.

Q. Is he a director?

A. He is a director; yes, sir.

Q. So he is a director of both corporations?

A. Yes, sir.

Q. He resides down at Sweet Home, Oregon, does he? A. No, sir; Albany, Oregon.

Q. Who else was present representing Oregon Plywood Sales Corporation? A. Nobody.

Q. What about Mr. Sadoff, assistant treasurer?

A. Mr. Sadoff was the office manager of Oregon Plywood Sales Corporation at that time. [49]

Q. You mean Oregon Plywood Corporation?

A. I mean Oregon Plywood Corporation. I am sorry.

Q. He was present; was he not?

A. He was present; yes, sir.

Q. Have you ever prepared any instruments before similar to what has been marked and received in evidence as Plaintiff's Exhibit 1?

A. No, I have never written a contract of that description.

Q. Oregon Plywood Sales Corporation has entered into a number of those contracts, has it not, similar contracts?

A. Not to my knowledge; no, sir.

Q. It has entered into none?

A. Not to my knowledge; no, sir.

(Testimony of Robert Hofheins.)

Q. What about Oregon Plywood Corporation?

A. No, sir, they have——

Q. Oregon Plywood Corporation has not either, you say? A. No, sir.

Q. You live in Buffalo, New York?

A. Yes, sir.

Q. You are out here just occasionally?

A. I am out here approximately once a month, sir.

Q. Did you read the complaint in this case after it was prepared by Mr. Anderson's office?

A. I think I have.

Q. And you approved the form of the complaint? [50]

A. I wouldn't know what you mean by that, sir.

Q. Was the complaint accurate and correct, so far as you were concerned?

A. So far as I recall, yes, sir.

Q. Did you take issue at all with the following language from paragraph II of the complaint:

"Plaintiff and defendant Sutherlin Plywood Corporation are parties to a contract whereby plaintiff was and is engaged—was and is granted the first right and option to buy at prices therein provided 80 per cent of defendant's output of plywood upon terms and conditions therein set forth."?

The question was, did you object to that at the time you read the complaint?

Mr. Anderson: I will object, your Honor. The complaint is not signed and verified by the parties.

The Court: That is the reason he asked if he



(Testimony of Robert Hofheins.)

be provided [53] with a copy of the deposition so he can examine it?

The Court: Yes.

Mr. Yerke: That is page 15. I am sorry.

The Witness: They are both correct, Mr. Yerke. Let me call your attention to the fact that when you asked a question a few minutes ago you asked if Oregon Plywood Sales Corporation had entered into any sales contracts. I said no. In this the question was asked if I had ever entered into any contracts. I said yes.

Q. (By Mr. Yerke): What contracts have you entered into?

A. Well, as an officer of other corporations, I have entered into sales contracts.

Q. A number of them?

A. Oh, I would say possibly two; maybe three. I don't recall exactly how many.

Q. You are familiar then with the general subject matter of such contracts, aren't you?

A. I would say in a general way; yes, sir.

Q. You testified concerning the meeting of the board of directors on July 28, 1954. That same meeting is referred to in the pre-trial order. You recall that meeting, do you not?

A. I do, sir.

Q. Were you handed a form of resolution that was to be adopted by the board or was under consideration by the board at that time? [54]

A. Yes, sir.

(Testimony of Robert Hofheins.)

Q. Did you suggest a change in the resolution before it was voted on? A. I did, sir.

Q. Did that particular suggestion relate to a leasing of the assets as distinguished from a sale of the assets? A. I believe that it did.

Q. Then when the resolution was voted on, how did you vote? A. I voted against it.

Q. How did you indicate your vote? Did you voice a No, or did you raise your hand, or what did you do?

A. Oh, I wouldn't remember that, Mr. Yerke.

Q. Did anyone else vote against it?

A. I don't recall.

The Court: Did you ask that your votes be recorded?

The Witness: I don't remember that I did, Judge, or I don't remember that I didn't.

The Court: Did anyone else besides yourself know that you voted against the resolution?

The Witness: I think that—it was my impression that I had expressed myself that unless the contract with the sales contract was to follow that I was against anything of that nature. I think I discussed that.

The Court: Tell me specifically about that.

The Witness: Well, of course, when the resolution was [55] up, came in, this resolution which had been drawn prior to the meeting, and it was presented, and I raised an objection to it.

The Court: What was the objection that you raised?

(Testimony of Robert Hofheins.)

The Witness: Well, the fact that there had been nothing included in there about sales contracts.

The Court: You insisted or you contended that any sale or lease must honor the contract that you had entered into with the Sutherlin Plywood Corporation on the 17th of December, 1953?

The Witness: Yes, sir.

The Court: Then when the time came to vote you voted against the contract?

The Witness: Yes, sir—against the resolution, sir. I didn't vote against the contract.

The Court: Against the resolution, all right.

Q. (By Mr. Yerke): Then following the matter did you assist in stuffing the envelopes with the notices to the stockholders of the voting on this resolution at the proposed stockholders' meeting?

A. I believe that I did.

Q. You did not attend that meeting, the stockholders' meeting, did you?      A. No, sir.

Q. You were advised that the meeting was to be held?

A. I was advised that there was to be a meeting to be held; [56] yes, sir.

Q. You were advised also of the board of directors' meeting which occurred after the stockholders' meeting?

A. No, sir, I don't believe I was.

Q. You testified that you first heard of this sale to Nordic Plywood, Incorporated in September or October?      A. Yes, sir.

Q. Didn't you as a creditor of Sutherlin Ply-

(Testimony of Robert Hofheins.)

wood get, receive a notice to creditors during the month of August, 1954?

A. Not that I recall; no, sir.

Q. When I say "you" I mean Oregon Plywood Sales Corporation or Oregon Plywood Corporation.

A. Not that I know of, sir. I don't recall it.

Q. Isn't it a fact, Mr. Hofheins, that, if you know, that the veneer plants that were supplying veneer to Sutherlin Plywood were union plants, or do you know?

A. No, I don't know. What was the date of that notice to creditors, Mr. Yerke?

Q. August 24th, I believe, 1954.

A. No, I don't recall anything like that.

Q. Do you recall a registered letter arriving in your office concerning that?      A. No.

The Court: Mr. Hofheins, didn't you make inquiry about how Sutherlin Plywood Corporation was getting along during the [57] months of July, August, September?

The Witness: They had substantial assets, your Honor.

The Court: Weren't you concerned about the fact that the plant was down?

The Witness: Yes, sure.

The Court: What did you do about it?

The Witness: Well, we—in May we—

The Court: I am talking about in August and September.

The Witness: Well, in August, on August 12th we wrote them a letter in connection with the fact.

(Testimony of Robert Hofheins.)

The Court: But you never went over to the plant at Sutherlin?

The Witness: No, sir.

The Court: You were in Oregon in August, and you were also in Oregon in September?

The Witness: No, not in August, sir. You see, the strike was on. I was here in July, and I attended that meeting, and then I was not in Oregon again until after the strike was over.

The Court: When was that?

The Witness: In September.

The Court: You did not communicate with any of the officers of Sutherlin Plywood Corporation to find out what progress was being made in connection with a sale or leasing of the plant?

The Witness: No, sir, I—at the July meeting I endeavored to find out the names of some of the people that they might [58] have who were interested, and I was not successful in getting that information, your Honor.

Q. (By Mr. Yerke): You commenced serving as a director on the board of directors of Sutherlin Plywood Corporation right after the first of the year in 1954; did you not?

A. Well, it was after the contract was signed, yes, sir.

Q. During the month of January?

A. I don't recall exactly when it was, but I know it was right after the contract was signed.

Q. You have never resigned? A. No.



(Testimony of Robert Hofheins.)

Q. When did you first contact Mr. Dezendorf at Mr. Anderson's office concerning this matter?

Mr. Anderson: If the Court please, I believe that is going beyond the scope of the direct examination. Perhaps it is part of the defendants' own case. I object to it at this time.

The Court: I do not see the relevancy anyway.

Mr. Yerke: We will withdraw it, your Honor. That is all.

Mr. Anderson: That is all, Mr. Hofheins.

(Witness excused.) [59]

### MARVIN D. STEINBACH

a witness produced in behalf of plaintiff, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

Q. (By Mr. Anderson): Mr. Steinbach, do you have any connection with the defendant Sutherlin Plywood Corporation? A. Yes, sir.

Q. What is your relation to that defendant?

A. I am a member of the board of directors and the secretary.

Q. When were you elected to secretary?

A. In the fall of 1951 when the corporation was first formed.

Q. Have you been the secretary continuously since that time? A. I have been.

Q. When, if ever, did you meet Mr. Robert Hofheins?

(Testimony of Marvin D. Steinbach.)

A. I met Mr. Hofheins, I believe it was November, 1953.

Q. Where did that meeting take place?

A. In Sutherlin at the plant of the Sutherlin Plywood Corporation.

Q. What happened at that meeting?

A. Mr. Hofheins stopped at the plant to look the plant over, and while he was there I was introduced to him, and in the course of the conversations the financial situation of the Sutherlin Plywood Corporation was discussed, and he intimated that he, through his connections, could probably furnish us [60] with working capital which we were endeavoring to raise.

Q. Was a sales contract discussed at that time?

A. No, it was not.

Q. What next happened in the relations between Sutherlin and Oregon Plywood Sales Corporation?

A. At the meeting when Mr. Hofheins was at Sutherlin a subsequent meeting was arranged to be held in Sweet Home at the office of his company there, and at the time agreed upon several of the members of Sutherlin Plywood Corporation's board of directors went to Sweet Home to meet Mr. Hofheins.

Q. What was the date of that meeting?

A. I don't recall. It would be some time——

Q. November or December, 1953?

A. It would be either late November or early December.

Q. What occurred at the Sweet Home meeting?

(Testimony of Marvin D. Steinbach.)

A. We met with Mr. Hofheins, and there was one other gentleman there from his company who was in and out of the room where we were talking, and at that meeting our financial situation was discussed, and Mr. Hofheins took pencil notes of what our conditions were and what we needed, and a subsequent meeting was set for the Eugene Hotel for a later date.

Q. What did you advise Mr. Hofheins and Oregon Plywood Sales Corporation concerning the intention, if any, of Sutherlin to continue operations to produce plywood?

Mr. Yerke: Same objection.

The Court: Answer the question. [61]

The Witness: We informed him that we hoped to keep in operation. That was the idea of forming the company in the first place, was to produce plywood.

Q. (By Mr. Anderson): You advised, did you not, that Sutherlin did continue—did intend to have a continuous operation?

A. I don't recall that we advised him that we would continue operation. We might have said that we hoped to continue.

Q. Do you recall your deposition, Mr. Steinbach, on December 20, 1955—page 12?

(Deposition presented to the witness.)

A. Yes, sir.

Q. Now, Mr. Steinbach——

The Court: How many witnesses of this kind have you got?

(Testimony of Marvin D. Steinbach.)

Mr. Anderson: There are three, I believe.

The Court: I am going to assume that each one is going to say that they intended to continue operation at least 50 months.

Mr. Anderson: Very well, that is what they have said.

The Court: Mr. Steinbach, I want to ask you a question. You said on two occasions that you discussed your financial condition with Mr. Hofheins. What did you tell him?

The Witness: We had the plant in order—I mean practically in position to start production, but we had no financial backing or any working capital, and we needed money to go out and buy veneers and to meet pay rolls, stuff like that; in other [62] words, working capital. The machinery was all in place. The down payments were made on it and contracts made on it and that.

The Court: You did not own the equipment?

The Witness: No, sir, we didn't own all of it. We owned part of it, but we didn't own all of it. It was being purchased on conditional sales contracts.

The Court: In order to get working capital you entered into this contract with Mr. Hofheins?

The Witness: That's right.

The Court: In which you gave them 80 per cent or option to purchase 80 per cent of your output, and you gave a mortgage securing \$80,000?

The Witness: That's right.

(Testimony of Marvin D. Steinbach.)

The Court: Are there any more questions of this witness?

Mr. Anderson: Yes.

Q. Mr. Steinbach, did you consider the contract with Oregon Plywood Sales Corporation profitable for Oregon Plywood Sales Corporation?

Mr. Yerke: We object to that.

The Court: It would not make any difference anyway. What difference would that make, Mr. Anderson?

Mr. Anderson: Well, I don't think it makes too much difference unless he thought it was unprofitable.

The Court: Well, I think they must have thought it was [63] necessary, in any event, to do that. It is a rather severe contract, isn't it, Mr. Anderson, when you give away 80 per cent of your production?

Mr. Anderson: No, your Honor, it is a very ordinary type of contract in the industry.

The Court: You have represented another company that has one of those right here at Milwaukie, Milwaukie Plywood, have you not?

Mr. Anderson: Well, they are quite common. Many of the plywood companies have them. It benefits the company in that they do not have to arrange for the sales, your Honor.

Q. Mr. Steinbach, did Sutherlin perform under this contract?

Mr. Yerke: Objected to as calling for a legal conclusion from a lay witness.



(Testimony of Marvin D. Steinbach.)

Mr. Anderson: I will rephrase the question.

Q. Mr. Steinbach, did Sutherlin commence production? A. They did.

Q. When did that occur?

A. Early January, 1954.

Q. Did Sutherlin receive the loan as agreed in the contract between the parties? A. Yes.

Q. Did Oregon Plywood Sales Corporation finance the purchases of green veneer?

A. Yes. [64]

Q. Did Oregon Plywood Sales Corporation advance 80 per cent of the invoices?

A. That I wouldn't know. I would have to check with the records.

The Court: Is there any dispute about these things?

Mr. Anderson: He has testified on this previously in his deposition that they did make the advance, and I do not think there is any.

The Court: Unless there is going to be some contradiction of your witness' testimony, I do not see any utility in putting on this cumulative evidence. If there is going to be a dispute, will you please let us know?

Mr. Yerke: Yes, your Honor, there will be a dispute as to whether or not they advanced 80 per cent of the invoice amount upon the receipt of invoice as stipulated in the sales agreement. We will show by records they did not upon receipt of the invoice, which is what was required by the agreement.

The Court: When did they do it?

(Testimony of Marvin D. Steinbach.)

Mr. Yerke: I believe that the records indicate that starting with invoice 29 they failed to do that.

The Court: Did they do it at a later time?

Mr. Yerke: There were credits made back and forth at a later time, but most of that occurred, I believe—again I would have to refer to the records—after production had ceased. [65]

The Court: Was it a substantial difference?

Mr. Yerke: I believe at the time there were invoices covering 35 cars where there had not been an advance of 80 per cent of the invoice amount, but I would want to check the records to be sure. We intend to have testimony on that.

The Court: You go right ahead.

Mr. Anderson: All right, your Honor.

Q. Referring to page 15 of the deposition, Mr. Steinbach, on line 19, do you recall my asking you: "What did they do in regard to the advances on the invoices?" And your answer: "They advanced 80 per cent less the cost of financing." Was that your testimony? A. Yes, sir.

Q. Mr. Steinbach, at the time of your shutdown of Sutherlin were any lawsuits pending against Sutherlin Plywood Corporation? A. Yes.

Q. What lawsuits were pending against Sutherlin?

A. There was one for Winkler Machinery Company of Seattle. There was threat of lawsuit by the Federal Government for withholding taxes.

Q. I beg your pardon, did you say a threat or a suit?

(Testimony of Marvin D. Steinbach.)

A. A threat, T-H-R-E-A-T (spelling). [66]

Q. Perhaps you misunderstood the question, Mr. Steinbach. What I am asking is whether at the time you shut down in April there were then pending any lawsuits? Had anybody sued Sutherlin at that time?

A. Oh, no.

Q. Pardon? A. No, sir.

Q. Has anybody sued Sutherlin since that date other than the plaintiff in this case?

A. No, sir; not to my knowledge.

Q. Were all employees of Sutherlin shareholders?

A. With the exception of a few.

Q. How many?

A. Oh, probably three or four.

Q. Mr. Steinbach, what was the opinion of the board of directors in regard to whether they were or were not bound by the contract with the plaintiff?

The Court: What difference would that make?

The Witness: I don't know what the opinion of the complete board would be. I can only answer for myself.

The Court: What difference would it make what these people thought. Isn't that what your client hired you for and that is why Mr. Yerke is here?

Mr. Anderson: Yes, that is true, your Honor. I simply wanted bring out that they considered the contract in force. [67]

Q. Mr. Steinbach, did you consider the sales contract between Sutherlin and the plaintiff in force up until the time of the sale of the mill?

(Testimony of Marvin D. Steinbach.)

A. I beg your pardon, what was the last of that, up until the when?

Q. Up until the sale of the mill.

A. As long as Sutherlin Plywood Corporation was producing plywood, I considered that the sale contract was valid or in force.

Q. I believe that you have said that you also considered it valid as long as Sutherlin owned the plant, is that correct?

A. I don't get what you mean by that.

Q. Well, the point I am asking about is whether or not you considered the contract in force up until at least up until the time you sold the plant to Nordic? A. Yes.

Q. Did you inform Nordic Plywood, Incorporated during the negotiations for the sale that the sales contract was in force? A. We did.

Q. Do you recall a strike in the industry in the summer of 1954?

A. I do now. I didn't when my deposition was taken.

Q. What happened to the plywood market when the strike occurred?

Mr. Yerke: Objected to as incompetent. Mr. Steinbach [68] has not been qualified on that.

Mr. Anderson: He is an officer of the plywood corporation, your Honor.

Mr. Yerke: Mr. Steinbach is a trucker. He is trying to ask him questions as if he were a lawyer.

Mr. Anderson: If he knows. If you know.

The Witness: I don't know.

(Testimony of Marvin D. Steinbach.)

The Court: Is there any question about that? Didn't the price go up during the strike?

Mr. Yerke: I don't know how far it went up, your Honor. I think it did become more firm. It was quite soft in the spring, and the later it did go up appreciably, but I am not sure that that started in June as is claimed.

The Court: I have got the index figures. Mr. Anderson's partner introduced them in another case, and we will give them to you.

Q. (By Mr. Anderson): Mr. Steinbach, was Sutherlin Plywood Corporation ever advised by Nordic Plywood Incorporated that Nordic would not perform the conditions under the sales contract?

A. They informed us that they would not go through with the sale if they had to abide by that.

Q. And the Sutherlin Plywood Corporation knew at the time the sale was made that the contract was being terminated; did they not? [69]

A. I beg your pardon?

Q. Would you read the last question?

(Last question read.)

The Witness: I guess you would call it that.

Q. (By Mr. Anderson): At any rate, you knew that Nordic was not going to give the production to the plaintiff in this case? A. Yes.

Q. At the time the market improved did you give any thought to starting up again?

(No answer.)

The Court: Did you hear the question?



(Testimony of Marvin D. Steinbach.)

The Witness: Yes, sir.

Mr. Yerke: Will you tell him when the market improved or *asked* him to assume when it improved?

Mr. Anderson: I think that is something we have to stipulate on.

The Court: Well, you fix the date.

Mr. Anderson: I will withdraw the question for the time being. You may examine.

### Cross Examination

Q. (By Mr. Yerke): How many employees did Sutherlin Plywood Corporation have when it was operating?

A. In the neighborhood of a hundred.

Q. Did you ever examine the ledger and journals of Sutherlin [70] Plywood Corporation?

A. Not extensively; no, sir.

Q. Have you had any bookkeeping experience?

A. No, sir.

Q. Legal training? A. No, sir.

Q. What is your business?

A. I am a trucker.

Mr. Yerke: That is all.

Mr. Anderson: That is all, Mr. Steinbach.

(Witness excused.) [71]

### CHARLES M. WOOD

a witness produced in behalf of the plaintiff, having been first duly sworn, was examined and testified as follows:

### Direct Examination

Q. (By Mr. Anderson): Mr. Wood, do you

(Testimony of Charles M. Wood.)

have any connection with defendant Sutherlin Plywood Corporation?      A. I do.

Q. What is that connection?

A. I am the president of the corporation.

Q. How long have you been president?

A. Since the beginning of 1953.

Q. When did you meet Mr. Robert Hofheins?

The Court: Are you going through those same questions?

Mr. Anderson: Well, not all of them, your Honor. I think we can shorten this up.

The Court: I think he must know Mr. Hofheins. What is your business?

The Witness: I am a logger.

The Court: You are a logger.

Q. (By Mr. Anderson): Mr. Wood, were you present at the Sweet Home meeting when this was discussed?      A. Yes, I was.

Q. What happened at that meeting?

A. Oh, we discussed the possibilities of receiving finances [72] from Mr. Hofheins' companies and they obtaining some of our production.

Q. What was contemplated by Sutherlin Plywood about continuous production?

The Court: I told you I will assume that all these witnesses will testify the same way that the previous witness did.

Mr. Anderson: Yes, your Honor.

The Court: They hoped to be able to continue for at least 50 months.

(Testimony of Charles M. Wood.)

The Witness: The object was to produce as long as there was a market.

Q. (By Mr. Anderson): Mr. Wood, did Sutherlin receive the loan of \$80,000? A. They did.

Q. Did they receive an 80 per cent advancement on the invoices?

A. Most of the time or sooner or later.

Q. Is your answer then that it did receive the advances? A. Yes.

Q. Did they receive the advances on the green veneer?

A. No, that was paid direct to the company that produced the veneer.

Q. All right, but the plaintiff obtained and purchased the green veneer? [73]

A. As far as we know.

Q. What kind of a manager did Sutherlin have in the spring of 1954?

A. What kind of a manager?

Q. Yes. A. Plywood plant manager.

Q. Well, was he good, bad, or indifferent?

A. Well, he was recommended to us as a very good plywood manager by quite a few people. One of them was Franklin Hofheins.

The Court: That doesn't answer the question. Was he any good?

The Witness: I wouldn't know.

Q. (By Mr. Anderson): Did you feel that he lived up to the recommendations? A. No.

Q. What did you do about it when you found it out?

(Testimony of Charles M. Wood.)

A. We looked around for someone to replace him.

Q. Did you ever replace him? A. No.

Q. Did you have any talk about starting up again after you shut down? A. Certainly.

Q. Was it your intention to start up again?

A. Yes.

Q. Why was it you didn't start up again in September when [74] the market was strong?

A. We didn't have the finances to get into production.

Q. You didn't have the mill either, did you?

A. We certainly did.

Q. Hadn't you sold it in September?

A. Not the first half of it.

Q. But you had—when did you sell it?

A. The contracts are dated—you probably have copies of it.

Q. When did Nordic start production?

A. By the very last of September.

Q. Did the board of Sutherlin consider the contract in force at least up until the sale to Nordic?

A. They probably did.

Q. As a matter of fact, that was the general feeling among the board of directors; was it not?

A. I wouldn't know about the rest of them. There was never a vote taken on it.

Q. Didn't you so testify in your deposition?

A. It's hard to tell.

(Deposition presented to the witness.)

The Court: I will assume that he did, but, Mr.

(Testimony of Charles M. Wood.)

Anderson, I don't know what the contract being in force means.

Mr. Anderson: I do not want to take up the Court's time, but I feel it may have some—— [75]

The Court: I am sure if I do not know what it means exactly that these witnesses probably do not know what it means.

Q. (By Mr. Anderson): Let me ask you this, Mr. Wood: Did the board of directors consider Sutherlin was bound by the contract with the plaintiff at least up until the sale?

A. As long as they were in production.

Q. Or as long as they had the mill?

A. As long as they had the plant. After our production shut down or our plant shut down our production was nothing. 80 per cent of nothing is an awfully small piece of plywood.

Q. As long as you had the plant you were bound to give 80 per cent of the production to Oregon Plywood Sales Corporation? A. That's right.

Q. Now, in the summer of 1954 did you receive some offers to buy the plant? A. We did.

Q. Quite a number of them, weren't there?

A. There was.

Q. Would you tell the Court who you received them from? A. Pacific Plywood.

Q. Aetna Plywood? A. Aetna Plywood.

Q. Colorado Fuel and Iron?

A. No, we didn't. Colorado Fuel and Iron was to finance [76] us to get into production before. Our



(Testimony of Charles M. Wood.)

negotiations with them was to reopen the plant earlier.

Q. Well, in your deposition I believe you said that they made an offer, but you say now it was not an offer from Colorado for this financing?

A. That was financed before, yes.

Q. Did you receive an offer to buy from Campbell and MacLean?

A. We did, and also a firm by the name of Johnson.

Q. Did you receive any other offers?

A. Well, not that I remember right now.

Q. But there were several other people who were interested and discussed the purchase of the mill; isn't that correct?

A. That's right.

Q. In fact, there was quite a lot of interest in acquiring the mill in Sutherlin; was there not?

A. Well, most companies that are in the business are willing to expand at any time.

Q. Did Sutherlin know before the sale that Nordic Plywood, Incorporated was not going to give 80 per cent of production to Oregon Plywood Sales Corporation?

A. They did.

Q. Did Sutherlin Plywood Corporation inform Nordic Plywood of the sales contract?

A. Yes.

Q. Did Sutherlin have any other mill? [77]

A. No.

Q. At the time of the sale did Sutherlin know that there would be no further performance of the sales contract?

A. At the time of the sale?

Q. Yes.

A. Yes.

(Testimony of Charles M. Wood.)

Q. Were orders placed with Sutherlin by Oregon Plywood Sales Corporation after the sale?

A. Yes, which was a very foolish thing to do.

Q. What happened to the orders?

A. Sent them back.

The Court: I do not think there is any dispute about that. You have asked the question of the other witnesses, and it is stipulated in the pre-trial order.

Mr. Anderson: Very well, your Honor. You may examine.

#### Cross Examination

Q. (By Mr. Yerke): These efforts to purchase the plant by Pacific Plywood, Aetna, and I believe you referred to a man by the name of Johnson, did they come to you, or did you go to them?

A. Both.

Q. Who is Johnson?

A. Well, I don't know his first name. They call him Smoky Johnson. He has a plant down by Grants Pass.

Mr. Yerke: That is all. [78]

The Court: In these offers were you offered as much as \$600,000 for the plant?

The Witness: Yes.

The Court: Why didn't you take those offers rather than the one from Nordic?

The Witness: This one was \$660,000.

The Court: Was Nordic the highest and best offer that you received?

(Testimony of Charles M. Wood.)

The Witness: It was not the highest, but we felt it was the best. Of course, there was so little difference in the price that it might just as well have been the highest.

The Court: That is all.

Mr. Anderson: That is all.

Mr. Yerke: That is all.

(Witness excused.) [79]

### CHARLES A. PETHERICH

a witness produced in behalf of plaintiff, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

Q. (By Mr. Anderson): Mr. Petherich, what relation do you have to the defendant Sutherlin Plywood Corporation?

A. On the board of directors, and I am the treasurer.

Q. How long have you been the treasurer?

A. Since the last — summer of 1953, I believe it was.

Q. Mr. Petherich, do you know of any right that Sutherlin had to terminate its contract with the plaintiff?

A. I believe that's illegal. I wouldn't know myself, no.

Q. Mr. Petherich, did you state on your deposition that you knew of no reason they had to terminate the contract? A. Well——

The Court: I think his answer here today is a

(Testimony of Charles A. Petherich.)

good one. Perhaps this is a witness who would know something about that 80 per cent, the advances made. He was the treasurer of the corporation. What is your business?

The Witness: I am an insurance agent, sir.

The Court: You are an insurance agent?

The Witness: Yes, sir.

The Court: Were you in the plant working full time?

The Witness: No, sir. [80]

The Court: Did you keep all the books and records of the company?

The Witness: No, sir, we had an office manager and bookkeepers to do that.

Mr. Anderson: I have not examined about that 80 per cent. I do not believe he has any knowledge.

Q. Mr. Petherich, did Sutherlin believe when it sold its plant that it was terminating the contract? A. I believe it did.

Mr. Anderson: You may examine.

Mr. Yerke: No questions.

The Court: That is all.

(Witness excused.) [81]

### JOHN R. ADAMS

a witness produced in behalf of plaintiff, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

Q. (By Mr. Anderson): Mr. Adams, do you have some connection with the defendant Nordic Plywood, Incorporated?

(Testimony of John R. Adams.)

A. Yes, I am the president of Nordic.

Q. How long have you been the president?

A. Since its inception.

Q. When did you first hear of the sales contract between Sutherlin and Oregon Plywood Sales Corporation?

A. I don't recall the exact date, but it was on a visit to Sutherlin when I stopped in at the plant down there once.

Q. What time of the year was that?

A. Well, I would say that I am very poor at remembering dates.

Q. Let me put it this way. Did you know about this sales contract all the time during the negotiations for the sale?      A. Yes.

Q. Did you have discussions about this sales contract with Sutherlin?

A. Yes, as I recall, we did.

Q. When you purchased the mill did you intend—when I say “you” I mean Nordic Plywood, Incorporated—intend to perform the contract, that is, give Oregon Plywood Sales Corporation [82] 80 per cent of the production?

A. No, we didn't.

Q. Did you know that that contract between Sutherlin and Oregon Plywood Sales Corporation would be terminated if you bought the mill?

A. Well, I wouldn't know what they would do with it.

Q. Didn't you know as a fact that the contract would be terminated if you bought the mill?



(Testimony of John R. Adams.)

A. Well, I would assume that it would. I didn't know that.

Q. But you knew Sutherlin had no other mill; did you not?      A. That's right.

Q. Didn't you testify in your deposition that you knew the contract would be terminated when you bought the mill?

The Court: I think the testimony is a word of art. He has already indicated that they had no other plant, and he assumed they would not be able to comply with the contract; isn't that right?

The Witness: Yes.

Mr. Anderson: Very well, your Honor.

Q. Were orders ever presented by Oregon Plywood Sales Corporation to Nordic after it commenced operation of the plant?

Mr. Yerke: They are already in evidence, your Honor. We will stipulate they were received.

Q. (By Mr. Anderson): What happened to the orders which were given to you by Oregon Plywood Sales Corporation?

The Witness: I think they were returned to your law office. [83]

Q. Did you reject them?

A. Yes, we did.

Mr. Anderson: You may examine.

### Cross Examination

Q. (By Mr. Yerke): The pre-trial order recites, Mr. Adams, that Nordic Plywood, Incorporated, was organized on September 3, 1954. You re-

(Testimony of John R. Adams.)

call that, don't you?      A. Yes.

Q. When did you first start negotiating for the purchase of the assets of Sutherlin?

A. Possibly around July 7th, along in there, I would say, when we actually got down to negotiating.

Q. Was Nordic organized after you had been advised that the assets would be sold to you?

A. Evidently it was. I don't recall the date of their board meeting and when they decided to sell, but we were organized after that time.

Mr. Yerke: That is all.

Mr. Anderson: That is all, Mr. Adams.

The Court: That is all.

(Witness excused.) [84]

### NORMAN H. JACOBSON

a witness produced in behalf of plaintiff, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

Q. (By Mr. Anderson): Mr. Jacobson, what relation, if any, do you have to the defendant Nordic Plywood, Incorporated?

A. I am secretary-treasurer.

Q. How long have you been secretary-treasurer?

A. Since the company was organized.

Q. When did you first hear of the sales contract between Sutherlin and the plaintiff?

A. Sometime after July 7th, I think, between the 7th and the 15th.

(Testimony of Norman H. Jacobson.)

Q. What year? A. 1954.

Q. Were you aware of the sales contract during the negotiations for purchase of the plant?

A. I was.

Q. Mr. Jacobson, you knew, did you not, that the purchase of the plant by Nordic terminated or made it impossible for the sales contract between Sutherlin and the plaintiff to be performed; did you not? A. I suspected that; yes.

Q. Well, you knew that with the plant sold that Sutherlin [85] was disabled from performing; did you not?

A. Well, I did, and I don't think that Nordic Plywood could have operated under a sales contract of that type.

Q. During the negotiations did you discuss this contract with Sutherlin?

A. Not that I recall to any great extent, no.

Q. But it was discussed, was it not?

A. I think it was at the attorney's office, yes.

Q. And as a representative of Nordic, you discussed it with representatives of Sutherlin?

A. I think we did at the attorney's office, yes.

Q. There isn't any doubt about it? It was discussed?

A. Well, we did, yes. I don't recall where—it might have been just informal talk.

Q. But you discussed the fact that you were not going to supply your plywood and that Sutherlin could not at this time supply plywood to the plaintiff? A. That is right.

(Testimony of Norman H. Jacobson.)

Mr. Anderson: You may examine.

Mr. Yerke: No questions.

(Discussion off the record.)

(Witness excused.)

Mr. Anderson: We will produce Mr. Thompson and present him for questioning. You may then cross examine him.

The Court: I want to know what the financial condition [86] of this company was. I want to know what was represented to the plaintiff with reference to the financial condition at the time the contract was entered into. I want to know why the company lost money during the brief period in which it was in operation. I want to know the extent to which Mr. Hofheins was kept informed as to the activities of Sutherlin Plywood Corporation. I also want to know what differences there were in the operations between Nordic Plywood and Sutherlin, the extent to which new equipment has been furnished.

That is about all I can think of, but you do not have to put on six witnesses to prove one point.

Mr. Anderson: We will attempt to restrict it, your Honor.

(Thereupon, the evening recess was taken.)

Portland, Oregon, Wednesday, March 28, 1956, at 10:00 a.m., Court reconvened, pursuant to adjournment, and proceedings herein were resumed as follows:

The Court: All right, Mr. Anderson.

Mr. Anderson: Your Honor, the parties have conferred regarding an open account, and we have reduced some of the items, but we still have a conflict on a couple of items.

The Court: What are the items?

Mr. Anderson: And I wanted to advise the Court. One is in regard to whether or not certain assignments of accounts were taken in payment or as security. We are willing to confer later in the day and try to arrive at some decision on those, but I don't believe we can get together on that item since we have conflicting facts as to whether the assignments of accounts were in payment or security. We are prepared to put in testimony on that point.

But if that is to be an issue, and it appears that it will be—I gathered from Mr. McClanahan this morning that he will not concede that the accounts were given as security but contends that they were given as payment.

The Court: All right. Put on your case, then.

Mr. Anderson: I want to advise the Court that if the Court still wants authorities on the point about the admissibility [88] of the negotiations of the parties, I have authorities which I mentioned yesterday.

The Court: What do the cases hold?

Mr. Anderson: The cases hold, your Honor, that in order to properly construe a contract in this type of case the negotiations are admissible.



The Court: You mean where there is no ambiguity?

Mr. Anderson: If there was absolute unambiguity, your Honor, then probably not. But if there is a question of construction in view of the recitals evidence of negotiations may be admitted—not to vary the language but to assist in the proper construction of the language.

The Court: All right. Give me the cases.

Mr. Anderson: Great Lakes & Salt Lake Transportation Company vs. Scranton Coal Company, in 239 Federal Reporter at page 608, which cites United States vs. Bethlehem Steel Company, 205 U. S. 105.

The Court: What other cases?

Mr. Anderson: Those are the only two cases I mentioned on that point, your Honor.

The Court: All right.

Mr. Anderson: I do want to call to the Court's attention one other authority which we will rely upon in regard to the breach of the contract and the interference, a case decided in this court by Judge Fee, McKenney vs. Buffelen Manufacturing [89] Company, Civil No. 6198.

The Court: Is that one that was just affirmed by the Court of Appeals?

Mr. Anderson: Affirmed by the Court of Appeals as modified as to amount but not as to liability on February 29th, 1956.

The Court: I have been reading it just recently.

Mr. Anderson: The appellate decision does not discuss this particular point in great detail, but it

does affirm and says that the contrary contention is without merit.

Mr. Yerke: I am not familiar with that case. Was the seller there in financial difficulties as here?

The Court: That was a case involving Errion, who was one of the leading defrauders in this area. I don't think any such claim is being made here. He has fraud judgments from here to Seattle and Tacoma, to Spokane and various other places.

Mr. Anderson: Your Honor, the man Errion was involved in that and, as the Court said, he was the one that led them to the point of no return. But he was not a party in that case. This case rested upon what the defendants did; not what Errion did.

The Court: Go ahead and put on your case. [90]

### HENRY L. THOMPSON

was produced as a witness in behalf of the Plaintiff and, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

Q. (By Mr. Anderson): Mr. Thompson, what is your relation to the plaintiff, Oregon Plywood Sales Corporation?

A. I am Assistant Sales Manager of that corporation.

Q. Are you familiar with the market conditions in the plywood industry and have you been so familiar since January 1, 1954?

A. From January 1, 1954?

Q. Yes. A. Yes, I am.

(Testimony of Henry L. Thompson.)

Q. What was the status of the plywood market in the spring of 1954?

A. In January of 1954 it was a market of about \$85 list. In the spring of '54 it started to weaken, the tail end of January of '54 the market weakened in price, and it went back and forth from a \$80 list to a \$76 list. By that I mean quarter inch AD prices. Those prices, in my recollection, stayed until the strike occurred in the industry about the middle of June, 1954. Of course, the mills that were operating at that time were immediately—went up in price, and it was profitable for them. The price went up to \$85 and sometimes as high as \$90 to \$95. [91]

Q. Now Mr. Thompson, what has been the status of the plywood market since the spring of '54?

A. I would say that the plywood market has been very good since the strike.

Q. Mr. Thompson, what kind of orders did Oregon Plywood Sales Corporation place with the defendant Sutherlin?

A. We placed orders with Sutherlin as they asked for them, the type of orders that they asked for we tried to give them.

Q. Could Oregon Plywood Sales Corporation have placed at least \$100,000 per month of orders with Sutherlin during the period from the time they shut down up until the strike started?

A. I am sure that we could. We could have placed \$100,000.

Q. Did you have orders available?

(Testimony of Henry L. Thompson.)

A. We had orders available.

Q. To fill those orders?

A. During all that period; that is right.

Q. What amount of orders could you have placed with Sutherlin after the strike commenced?

A. Well, I would say we could have placed three times that amount if they could have handled them, because we had a freeze of orders and we had a heavy order file that we could have placed.

Q. Could you have placed at least \$200,000 per month with Sutherlin after the strike started?

A. Yes, I am sure we could. [92]

Q. For how many months would that have continued?

A. We could have continued right up until the present time?

Q. Are you prepared to place orders today?

A. I could place orders today. We would be glad to and could place orders up to 20 or 30 cars right today.

Mr. Anderson: You may examine.

### Cross Examination

Q. (By Mr. Yerke): How many orders did you place with Sutherlin in January of 1954? What was the dollar amount?

A. The dollar amount—I can't offhand tell you that, but I do know that from the time that this agreement was set, which was the latter part of December, up until the early part of January my recollection is that I placed about 20 or 25 orders

(Testimony of Henry L. Thompson.)

for sheeting in grades that they wanted to start their mill. My recollection is also that about the middle of January or the early part of January that we received a wire that the orders were coming too fast; slow up.

Q. When did you place the first 25 orders?

A. They were placed in the latter part of December and the early part of January.

Q. Isn't it a fact that the first orders you placed were on December 31st, 1953, and you wrote out the orders in longhand?

A. I wrote some orders out in longhand. [93]

Q. The orders that were placed were orders that were placed by Oregon Plywood Sales Corporation; isn't that right?

A. They were placed by Oregon Plywood Sales Corporation.

Q. They were not in response to orders or suggested orders from Sutherlin Plywood Corporation?

A. Oh, yes, they were. They were suggested orders and in the specifications that they wanted to start their mill up.

The Court: That wouldn't make any difference. Find out about what happened at the time the plant shut down, how many orders were unfilled.

Q. (By Mr. Yerke): How many orders did you have on hand at the time the plant shut down on April 21st, 1954?

A. Well, we had a number of orders, of course, in the office that we had not placed with them be-



(Testimony of Henry L. Thompson.)

cause they refused to take any more orders. They had nothing to make them with. And we also had about seven or eight orders—nine orders, I believe, roughly—that they still had unfilled.

Q. In other words, to answer the question, they had seven or eight or nine orders unfilled at the time they shut down?

A. They had refused orders prior to that.

Q. They had refused orders? A. Yes.

Q. Who had refused orders?

A. Because they didn't have any veneer or glue to make them with. [94]

Q. They didn't have any glue or veneer to make them? A. That is right.

Q. That is the reason they refused the orders?

A. They refused some orders at that time.

Q. Did you maintain a 30-day order file with them during the period they were operating?

A. To our best ability we did, but with the different stoppages on orders I don't know whether we had a 30-day order file or not. It was pretty hard to determine upon a 30-day order file the way things were running.

The Court: This stoppage, I don't understand what you mean by "stoppage."

Q. (By Mr. Yerke): Let me ask you: What do you mean by "stoppage"?

A. Where they stopped us from sending orders at different times.

Q. Let's take the period through March of 1954.

(Testimony of Henry L. Thompson.)

Did you maintain a 30-day order file up through that particular period?

A. May I ask this question just before answering? At that period of time what was a 30-day order file?

Q. What does that mean to you as a man that is in the plywood market?

A. According to their schedule of anticipated production, which I assumed was somewhere around 2,000,000 feet, supposedly, but they could be high on it, on their production I would say yes, we had a 30-day order file most of the time. [95]

Q. What does a 30-day order file mean to you as a plywood man?

A. What does that mean? Well, that means 30 days of production in that mill.

Q. In other words, you would have on hand orders which would cover their production for the next 30 days?

A. Cover production for 30 days, yes.

Q. Is it your testimony that for the months of January, February and March of 1954 you had on hand with Sutherlin Plywood Corporation orders which were sufficient to cover their production for the next 30 days at all times; is that your testimony?

A. That is my understanding. We gave them orders as they wanted them.

Q. Is that your recollection based upon the orders that you gave them at that time?

A. That is my recollection.

(Testimony of Henry L. Thompson.)

Q. You are the person who gave the orders to them, are you not?

A. I am the one that ordered them——

The Court: Mr. Yerke, I was wondering when you brought it up yesterday and again today what the relevancy of the 30-day order provision is. Are you contending that that is the basis for the plant closing, that they didn't have the 30-day order file?

Mr. Yerke: It was not the reason for the plant [96] closing necessarily, your Honor, but it is our position here that if this is an enforceable agreement there were breaches or there was a failure of consideration on the part of the plaintiff prior to the time that this asserted breach on our part occurred.

The Court: That is just grabbing at straws, isn't it, this particular line of attack? It seems to me we ought to try the case on the main issue.

Mr. Yerke: All right. That is all, Mr. Thompson.

### Redirect Examination

Q. (By Mr. Anderson): Mr. Thompson, did you after the mill shut down make attempts to place orders on the same terms with other mills?

A. Yes, I did.

Q. Did you make a number of those attempts?

A. Why, I would say many, many attempts. I called on the West Coast for days and days, every day, trying to get——

The Court: What do you mean on the same terms, 5 per cent off the list price?

(Testimony of Henry L. Thompson.)

Mr. Anderson: That is what I meant.

The Witness: Of course I tried to, but I wasn't successful.

The Court: Of course, nobody was selling during the strike, were they? Anybody who was producing plywood could sell it without any difficulty?

A. Well, somebody had to sell it. [97]

The Court: It was just a matter of accepting orders at that time, wasn't it?

A. And trying to fill them.

The Court: All right. He doesn't have to prove that. You don't have to go any further.

Mr. Anderson: I have a long list of calls that he made——

The Court: Oh, there is no use of that. It is pretty obvious that if he had orders he was trying to fill those orders.

Mr. Anderson: All right.

The Court: I don't think there is any question that he found it difficult, if not impossible, to fill those orders elsewhere at the same price that Sutherland had been filling them.

Mr. Yerke: That is the extra 5 per cent there we want, your Honor.

Mr. Anderson: That is all, Mr. Thompson.

(Witness excused.) [98]

F. W. VanHORN

was produced as a witness in behalf of the Plaintiff and, having been first duly sworn, was examined and testified as follows:

(Testimony of F. W. VanHorn.)

Direct Examination

Q. (By Mr. Anderson): What is your occupation, Mr. VanHorn?

A. I am Manager of the Linnton Plywood Association.

Q. What is your experience in the plywood industry?

A. I have worked in the plywood industry since 1941.

Q. What jobs have you had?

A. I started as a timekeeper and personnel man and worked as office manager.

The Court: What are you trying to qualify him as?

Mr. Anderson: Just his familiarity with the industry, your Honor.

The Court: For what purpose?

Mr. Anderson: It has no particular bearing on what we are going into. I will delete that question.

Q. Mr. VanHorn, are you familiar with contracts in the plywood industry granting the right to purchase a percentage of the output to a purchaser?

A. Yes.

Q. What are the common terms of discount in such a contract?

Mr. Yerke: Objected to as irrelevant and immaterial.

Mr. Anderson: I think the Court made some [99] comment yesterday about this contract, and I simply——

The Court: Linnton Plywood went into court to upset their agreement. Didn't you have a contract



(Testimony of F. W. VanHorn.)

that was so oppressive you came in and had it set aside?

A. That was a complete management contract, sir.

The Court: And it was also 5 per cent for the sales, wasn't it?

A. Ten per cent for the sales.

The Court: Ten per cent for the sales?

Mr. Anderson: The only thing I want to show is that this is the usual and ordinary type of contract, as I represented.

Mr. Yerke: We are concerned here, of course, with just one contract, your Honor, and what the practice might be between other corporations, firms or organizations certainly would have no bearing upon this. We are concerned with the construction of this particular agreement.

Mr. Anderson: As long as there is no contention that this contract is not oppressive——

The Court: I have seen other 5 per cent contracts. Malarkey has a 5 per cent contract or did.

Mr. Anderson: I am prepared to ask the witness about a number of them, your Honor, of which he has knowledge if there is any issue on it. I really don't think there can be.

Mr. Yerke: We haven't contended that the agreement was oppressive as a matter of defense. [100]

Mr. Anderson: All right.

Mr. Yerke: It may be oppressive, but I don't see that that particularly has any bearing on the

(Testimony of F. W. VanHorn.)

issues here. It undoubtedly was oppressive to some extent.

The Court: I am going to assume that that is not in issue.

Mr. Anderson: All right. Thank you, Mr. VanHorn.

(Witness excused.)

The Court: Over a period of time I learned something about the plywood industry. They all come in court at one time or another.

What about this claim that the assignments of the accounts were given in satisfaction as opposed to security?

Mr. Anderson: That is the next matter, your Honor. [101]

### ROBERT HOFHEINS

was recalled as a witness in behalf of the Plaintiff and, having been previously duly sworn, was further examined and testified as follows:

#### Direct Examination

Q. (By Mr. Anderson): Mr. Hofheins, do you recall an occasion in the spring of 1954 when certain accounts were assigned to you by defendant Sutherlin? A. Yes, sir.

Q. What were the circumstances surrounding the assignment?

A. There were two assignments or agreements. One covered an advance of \$11,000 which Oregon Plywood Sales Corporation made to Sutherlin for payroll purposes, and in that one they assigned

(Testimony of Robert Hofheins.)

an invoice or invoices from Western Door & Plywood Corporation in the amount of \$8,461.72.

Q. As I understand it, those were paid?

A. That was paid, but that was a collateral assignment.

Q. Now the next one.

A. Then on April 28th Sutherlin owed Oregon Plywood Corporation substantial amounts of money for veneer which had been shipped out in the form of plywood and for which they had never paid us, although according to the contract they were supposed to pay us at the time the shipment was made. But they represented to me that they didn't have the funds available to pay us when I contacted them, so they offered to me an assignment as [102] collateral or as security for the funds which they owed Oregon Plywood Corporation for the veneer. That assignment was signed by Mr. Steinbach as secretary, and at the time I took that assignment from him I specifically stated that our acceptance of it would be subject to Mr. Swan's approval, and it was definitely understood——

The Court: Who is Mr. Swan?

A. Mr. Swan was Secretary of Oregon Plywood Corporation, sir. And I definitely stated at that time it was my understanding that this would be a collateral or security assignment in lieu of the money that they owed us until such time as we might be able to collect these accounts.

Q. (By Mr. Anderson): Did I hear you correctly that this latter assignment was an account of

(Testimony of Robert Hofheins.)

the Coastal Lumber Company, or is that something else?      A. Coastal Lumber Company?

Q. What assignment were you talking about just now?

A. This last one of April 28th, the assignment of April 28th, included two invoices to Coastal Lumber Company, one for a car shipped April 16th and one for a car shipped April 19th.

Q. Is that the one you have just described?

A. That was the last one; yes, sir.

Q. Which you claim was an assignment as collateral?      A. Yes, sir.

Q. Were you familiar with the Coastal Lumber Company? [103]

A. We had had some communications with them; yes, sir.

Q. Did you know anything about their credit at that time?

A. Well, I will say this: that we would not sell them except on a sight-draft basis or on the basis of a 10 per cent deposit on the order and the balance sight draft because of their prior record and the record of the principals in the organization.

The Court: Was that one of the orders that you had sold or was that one of the orders that came directly?

A. That was one of the orders that they sold, sir, and shipped out the veneer on it without reimbursing us for it.

Q. (By Mr. Anderson): Did you ever accept that assignment as payment?

(Testimony of Robert Hofheins.)

A. No, sir. No, sir. Later on they sent us a statement which purported to show this as payment, and I immediately wrote them and called their attention to the fact that this was merely a collateral or security assignment.

The Court: How much of that was paid?

A. All but the Coastal Lumber Company, sir, and we received \$205 on the Coastal Lumber Company and there is a judgment against Coastal at the present time, but we are unable to locate the principal for examination. He has left and they don't know where he is.

The Court: How much is due on that invoice?

A. About slightly over \$6,000, I believe, sir.

The Court: How much are you claiming is due [104] on the account?

Mr. Anderson: The balance of the account I claim is a little over \$3,000. This is the principal item.

The Court: I thought there was another claim for damages.

Mr. Anderson: There are some minor claims, yes, your Honor, which I want to take up now.

The Court: All right. Go ahead.

Q. (By Mr. Anderson): Mr. Hofheins, in the statement which you prepared, the summary of plaintiff's open account claim, we have an item of \$1,556.80, which is shown as "Loss of cars accepted and not shipped by Sutherlin." A. Yes, sir.

Q. What does that represent?

A. Those represent orders which we had sold



(Testimony of Robert Hofheins.)

for them and which we had placed with them and on which we had their acknowledgment, and at the time they closed down they returned those two orders to us and said they would not be able to fulfill them. And of course we were obligated to the customer, so we had to go out and buy them to the best possible advantage and ship them. And that is our actual loss in the matter for those orders which had been accepted by Sutherlin.

Mr. Yerke: I move to strike that line of testimony, your Honor, on the ground that it relates to an unliquidated damage claim, whereas Mr. Anderson's claim here is purportedly on the basis of an open account. [105]

Mr. Anderson: An open account can be unliquidated, your Honor, but it is liquidated as far as we are concerned. We incurred the expense. There isn't any doubt in our minds about the amount.

The Court: I have some doubt about it, but I will let it go. I don't understand why the account is only about \$3,000 if he sustained a loss of \$6,000 on the shipment. Do you mean that Oregon Plywood Sales collected almost all of that from these other invoices?

Mr. Anderson: As far as the green veneer purchased, the \$214,000 and the \$160,000-odd figure we are together on. I believe that is correct. We are substantially together on those items; is that right?

Mr. Yerke: We are together on the gross amount of the green veneer purchased, which would be the

(Testimony of Robert Hofheins.)

figure of \$216,000. The amount of the discounts may be open to some dispute.

Mr. Anderson: I believe that we settled that this morning. In any event, these are additional items, your Honor. I don't believe there is going to be any difference between us on these big items. These are several small items. They contend we owe them a few thousand dollars and we contend they owe us a few thousand.

The Court: All right. I am going to let you put in your testimony.

Q. (By Mr. Anderson): Mr. Hofheins, you have [106] an item in the summary called "Expenses for Car 66555 in the amount of \$336."

A. Yes, sir.

Q. What do you claim on that item?

A. That was an order which was accepted by Sutherlin, and the order was shipped. It was for material which was to be oiled and edge-sealed, and when the car arrived at destination it was discovered that an error had been made and that the car that had been shipped was not oiled and edge-sealed.

The Court: Oiled and sealed?

A. Oiled and edge-sealed.

The Court: Oiled and edge-sealed.

A. Yes, used for concrete purposes.

The Court: I never heard of that. Tell me what that is.

A. Well, on concrete form panels they oil the

(Testimony of Robert Hofheins.)

surface of it so that when they strip the forms off from the——

The Court: It won't stick?

A. It won't stick; that is right. And the edge sealing is for the purpose of preventing the moisture, which is natural in concrete, from getting into the panel and possibly deteriorating the glue.

The Court: You had to divert the car to someone else?

A. No, the customer took the car, and then he went ahead and oiled and edge-sealed it, and these are the actual cash out of pocket expenses that we paid him. Actually, the claim was for \$436, and we told him that that was a little unreasonable [107] because he showed some overtime for labor, and as a result we got the claim reduced \$100.

The Court: Is there any dispute about that claim? Did you pay Sutherlin more for this——

A. Oil sealing?

The Court: Yes.

A. Yes, sir.

The Court: You had already paid it?

A. We had already paid them for oiling and edge sealing. It was a production error, you might say, a shipping error.

The Court: What about that?

Mr. Yerke: We are disputing it, your Honor. It is our position it is unliquidated. Sutherlin didn't have the facilities to make that type of veneer. And our records, as I understand it, do not disclose this letter which he has referred to in the

(Testimony of Robert Hofheins.)

reply, the letter of September 10th, 1954, so consequently we do feel we have to dispute that.

The Court: All right.

Mr. Anderson: The letter is in the exhibit.

Mr. Yerke: The point I am making is we have no record it was received, Mr. Anderson. It may have been. I can't say.

Q. (By Mr. Anderson): Did you send a letter to Sutherlin on or about September 10th, 1954?

A. Yes, sir.

Q. What was the substance of the letter? [108]

Mr. Yerke: We object to that.

The Court: Do you have the letter?

Mr. Anderson: The letter is in.

The Court: You don't have to tell us what is in it. You don't have to describe a letter that is in evidence.

Mr. Anderson: All right. On the other items we still have a good chance to get together, on the rest of them.

The Court: What about the \$860 item?

Mr. Anderson: That is deleted, your Honor. That shouldn't have been in there. That is not in the total figure. We agreed several days ago in consultation with opposing counsel to delete that.

The Court: Fine.

Mr. Anderson: I would like to reserve the opportunity to put on further testimony if we don't get together during the noon recess on the balance.

The Court: All right. You can do that. Any cross examination?

(Testimony of Robert Hofheins.)

Mr. Anderson: There is another item I would like to ask about.

The Court: All right. Go ahead.

Q. (By Mr. Anderson): Mr. Hofheins, would you explain how you originally charged Sutherlin for the green veneer purchased.

A. Yes, sir. At the time the cars were shipped and the invoices were received there was a formula [109] set up whereby we were to deduct so much per thousand square feet of plywood,  $\frac{3}{8}$  rough basis for the veneer that was in those cars, and to reimburse Oregon Plywood Corporation for the money they had paid out for this veneer. The original figure based on the base estimates that we could get was \$44 per thousand,  $\frac{3}{8}$  rough basis. At the time the inventories were made for the February 28th date it was discovered that they had been using more veneer than that original \$44 contemplated, and that the \$44 was not covering the amount of veneer which had actually been shipped as evidenced by the amount that they still had on hand. So that figure was raised to \$51 on a  $\frac{3}{8}$  rough basis. And about the middle of March I wrote them a letter calling attention to the fact that as of the end of February they owed us somewhere in the neighborhood of \$28,000 for veneer which had previously been shipped and for which a deduction had not been made. And we asked them for the check for that \$28,000 at that time.

The Court: What is the purpose of this testimony?



(Testimony of Robert Hofheins.)

Mr. Anderson: Your Honor, there is a contention that we did not advance 80 per cent of the invoices. What happened was that they got behind on the veneer payments, and not enough money was deducted originally from the veneer payments because the price was higher. Then when they were unable to make up the difference as the contract required it was necessary to credit future invoices. That is the explanation for their claim. [110]

The Court: I am going to tell you something, Mr. Anderson. I am really not concerned about these minor issues.

Mr. Anderson: All right, your Honor.

The Court: Because that is not the basis upon which the plant closed. I am interested in the principal issues, as I told you before. Let's stop reaching for straws.

Mr. Anderson: Yes, sir. You may examine.

### Cross Examination

Q. (By Mr. Yerke): Now the second assignment that you referred to, Mr. Hofheins, I believe you testified was executed on April 28th, 1954; is that correct?

A. It carries that date, sir.

Q. Does that accord with your recollection, that it was on or about that date?

A. Well, I believe that it probably was. That is the date of it; yes, sir.

Q. Where was that executed?

(Testimony of Robert Hofheins.)

A. I believe that was executed at Sutherlin, Oregon, sir.

Q. Was it executed in your presence?

A. I believe that Mr. Steinbach did sign it in my presence.

Q. Who else was present besides you and Mr. Steinbach?      A. I don't recall. [111]

Q. Now, following the execution of that assignment, or the accounts referred to in the assignment, did you make attempts to collect those particular accounts?      A. Yes, sir.

Q. Did you make attempts to collect the accounts that were assigned to Western Door & Plywood Company?      A. Yes, sir.

Q. And did you extend credit to Western Door & Plywood Company on those accounts?

A. Well, I wouldn't know whether we extended credit or not on those particular accounts. They sent us some notes when they couldn't pay, and then they paid off their notes.

Q. But on these particular accounts did you have discussions concerning the delay in payment whereby you authorized a delay?

A. With Western Door?

Q. Yes.

A. I don't believe we ever authorized a delay, no, sir.

Q. Do you recall ever advising Mr. E. C. Cunningham, Chairman of the Board of Directors of Sutherlin Plywood, that you had extended the time of those particular invoices?

(Testimony of Robert Hofheins.)

A. No, I recall advising Mr. Sutherlin that——

Q. You mean Mr. Cunningham?

A. I mean Mr. Cunningham—that we had not been able to collect them. But I don't recall that we ever extended any additional payments. We did [112] take notes to close it, and the notes were paid off. Now whether that is an extension of time or not I wouldn't know.

Q. Isn't it a fact that those notes related instead to the Western Door invoices assigned by the assignment of April 5th, 1954?

A. I don't believe so, sir. Those April 5th invoices I think were paid up, but I think these were the ones that were hanging fire, so to speak, and it took us a while before the notes were paid off.

Mr. Yerke: That is all.

Mr. Anderson: One other question, if I may, your Honor, regarding damages.

### Redirect Examination

Q. (By Mr. Anderson): Mr. Hofheins, have you prepared a summary of the profit and loss to Oregon Plywood Sales Corporation during the period that you got production from Sutherlin?

A. Yes. our bookkeeper prepared one.

Mr. Anderson: May we have that marked.

(The summary of profit and loss of Oregon Plywood Sales Corporation above referred to was marked by the Clerk Plaintiff's Exhibit 29 for identification.)

Q. (By Mr. Anderson): Mr. Hofheins, refer-

(Testimony of Robert Hofheins.)

ring to the document [113] which you mentioned, which is Exhibit 29 for identification, what does that show as the net result of that summary?

Mr. Yerke: Objected to as incompetent, irrelevant and immaterial. The exhibit would not bear on the measure of damages claimed by plaintiff in this case, which is 5 per cent mill value; and also on the further ground that no foundation has been laid for the answer by the witness.

The Court: I don't think that the profit and loss of the plaintiff corporation is of any probative value in this case for the reason that this was apparently a new enterprise for this company. That is, they had just taken on Sutherlin and they were going into a new field.

Mr. Anderson: What I intended to show, your Honor, was a comparative statement as to what the profit would have been if they had not had the production from Sutherlin. It is only for the five months. I agree with Mr. Yerke that the measure of damages is 5 per cent——

Mr. Yerke: I didn't say the measure of damages was 5 per cent. I said that is the measure you are claiming.

The Court: Yes. It is 5 per cent less expenses.

Mr. Anderson: Yes, that is right. That is offered simply as some corroboration and as some background, if the Court desires it.

The Court: To show that during the time that they did sell the plywood for Sutherlin they made more money? [114]

(Testimony of Robert Hofheins.)

Mr. Anderson: Yes.

The Court: I would just assume that. You don't have to prove that. I will accept the exhibit. The exhibit may be admitted. I am going to take it under advisement.

Mr. Anderson: Here is a supplemental exhibit that I would like to have marked as Exhibit 30.

(The summary of profit and loss statement above referred to, together with supplemental statement, were marked by the Clerk Plaintiff's Exhibits 29 and 30, respectively.)

Mr. Anderson: You may examine.

Mr. Yerke: No further questions.

(Witness excused.)

Mr. Anderson: Your Honor, subject to the damage feature which we hope to get together on during the noon hour, that is the plaintiff's case.

The Court: All right.

Mr. Yerke: We have some exhibits to offer, your Honor, which may simplify this if Mr. Anderson has no objection, and we won't have to call some of the witnesses as to the matters involved.

The Court: All right.

Mr. Yerke: We offer in evidence at this time Defendants' Exhibit 116, being the assignment of April 28, 1954. [115]

The Court: Is that an outright assignment?

Mr. Yerke: It so states on its face, your Honor, yes.

The Court: All right; go ahead.



Mr. Yerke: Is there any objection, Mr. Anderson?

The Court: No, no.

Mr. Anderson: No.

(The assignment dated April 28, 1954, above referred to, was received in evidence as Defendants' Exhibit 116.)

Mr. Yerke: We also offer at this time Defendants' Exhibits 117 and 117-A, being the memorandum agreement and assignment of April 5th, 1954, which Mr. Hofheins also testified to.

The Court: All right. It may be admitted.

(The memorandum agreement and assignment above referred to were received in evidence as Defendants' Exhibits 117 and 117-A, respectively.)

Mr. Yerke: We also offer in evidence at this time Defendants' Exhibit 118, being a notice to creditors of Sutherlin Plywood Corporation, together with return receipts signed by T. D. Sadoff of Oregon Plywood Corporation and Henry L. Thompson on behalf of Oregon Plywood Sales Corporation. This bears on the matter of notice which Mr. Hofheins testified about yesterday.

Mr. Anderson: I object to that, your Honor, for [116] the reason I see no relevancy to that document. It is Oregon Plywood Corporation and not the plaintiff. Although that is not particularly important, I see no relevancy to it.

Mr. Yerke: It was sent to both of them, your Honor. We have two cards here signed by a repre-

sentative of each, one at Sweet Home and the other at the Buffalo office.

The Court: All right. It may be admitted.

Mr. Anderson: I do object to the relevancy, your Honor. I see no relevancy or materiality to this notice of creditors on August 24th.

The Court: Mr. Hofheins said he never knew that the sale was going to be made until after the sales order was actually consummated.

Mr. Yerke: In September and October, he testified yesterday.

Mr. Anderson: I object to it.

The Court: Objection overruled.

(The notice to creditors above referred to was received in evidence as Defendant's Exhibit 118.)

The Court: Just give the numbers now.

Mr. Yerke: We offer Exhibit 120.

The Court: All right. Give the rest of them.

Mr. Yerke: Exhibit 121.

The Court: All right. The next one. [117]

Mr. Yerke: Exhibit 122, Exhibit 123, Exhibit 124, Exhibit 125, Exhibit 126, Exhibit 128-A, Exhibit 129-A——

The Court: Those are not marked. You just have 128 and 129 marked in the pretrial order. Is there a difference between them?

Mr. Yerke: They cover the same general subject, but we thought we would try to identify them. We are not offering everything in order to simplify the record.

The Court: All right.

Mr. Yerke: Exhibits 129-B, 129-C, 129-D, 129-E, 129-F, 130, 131, 132, 134-A, 134-B, 134-C, 134-D, 134-E, 134-F, 134-G, 134-H, 134-I, 136, 137, 138, 139, 140, 142-A, 142-B, 143, 145, 146, 149——

The Court: You haven't got 149. What is 149?

Mr. Yerke: Excuse me, your Honor. 149 would be a letter from Koerner, Young, McColloch & Dezendorf to Nordie Plywood, Inc., dated October 18, 1954.

The Court: All right.

Mr. Yerke: Exhibit 150 would be a letter from Koerner, Young, McColloch & Dezendorf to Nordie Plywood, dated October 19, 1954.

Exhibit 154 is a reconciliation of plaintiff's summary of open account to defendants' Exhibit 143.

We also offer at this time, your Honor, the journal of Sutherlin Plywood Corporation, being Exhibit 132-A. That [118] would be covered under accounting records. And we offer the ledger of the same corporation, being Exhibit 132-B.

The Court: All right. To which of these exhibits does the plaintiff object?

Mr. Anderson: If the Court please, I have not had an opportunity to examine part of them, principally the correspondence and letters. I have seen a number of the other documents.

The Court: Just go ahead and start and tell me which ones you object to.

Mr. Anderson: The first would be 128-A, your Honor, and 129-A through 129-F. We don't know what that involves.

Mr. Yerke: I am advised you have already ex-

amined those, Mr. Anderson, with Mr. Cunningham. They were made available to you about a week ago. All of those are either letters from Robert Hofheins or Franklin Hofheins. They are original letters. They may have already been offered by Mr. Anderson. I am not sure. I haven't checked the correspondence file.

The Court: He will have an opportunity to look at them.

Mr. Anderson: 132-A and 132-B I have not seen. I object to them until I have examined them.

136 and 137 and 138—I have not seen 136 and 137. I object to 138 as a letter from a lawyer to the defendant Sutherlin. I don't think it is relevant.

The Court: Isn't it relevant on the basis that the defendant contends that the sale of the plant [119] was based upon necessity and not because of any attempt to avoid fulfilling the contract; that it was a good faith transaction?

Mr. Yerke: Excuse me. I might state this and maybe it will clear it up, perhaps. We are not offering the letters, such as Exhibit 138, on the issue as to whether or not they had the right to sell, but we are offering it on the issue of their good faith. They did consult a number of lawyers to determine whether or not it would be proper for them to go ahead and sell. Only after having done that did they go ahead and make the sale. We are not offering the letter containing advice on the grounds that the advice is correct, but only on the issue of

good faith. They have alleged that we acted in bad faith.

The Court: I am going to admit 138.

Mr. Anderson: I wonder if I might ask that the letters from the other lawyers be produced. I understand the other opinions are contrary.

Mr. Yerke: I don't believe that has any foundation in fact, Mr. Anderson.

Mr. Anderson: That was the testimony on deposition. We will bring that out, then.

The Court: What numbers are they?

Mr. Anderson: They are not here. I just asked for them to produce the other letters.

Mr. Yerke: We will produce any and all opinions we have. [120] We have no reason to withhold anything.

Mr. Anderson: Exhibit 142-B, correspondence between James C. Dezendorf and George Luoma. It is my understanding that that relates to the payoff on the mortgage. There was a difference of \$236, but I feel that is now resolved.

The Court: If it doesn't refer to settlement negotiations don't you think it is admissible?

Mr. Anderson: If they still contend they are entitled to the \$236 it would have some bearing on it, yes.

The Court: All right. We will have that checked a little later. Go ahead.

Mr. Anderson: Those are the only objections, your Honor.

The Court: All right. At this time, all of the exhibits offered by Mr. Yerke, with the exception



of 128, 129, 132, 136, 137 and 142 are admitted. As to the exhibits the numbers of which I just read off I will take those under advisement. I am taking those under advisement to give you an opportunity to examine them during the recess at the noon hour. Will you let me know whether you withdraw your objections? If you don't withdraw them then I will pass upon the admissibility.

Mr. Anderson: Yes, sir.

The Court: All right.

(The documents above referred to, having been previously marked as Defendants' Exhibits 120, 121, 122, 123, 124, 125, [121] 126, 130, 131, 132, 134-A, 134-B, 134-C, 134-D, 134-E, 134-F, 134-G, 134-H, 134-I, 138, 139, 140, 143, 145, 146, 149 and 150, were received in evidence.)

#### HAROLD HAMBY

was produced as a witness in behalf of the Defendants and, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

Q. (By Mr. Yerke): Where do you reside, Mr. Hamby?

A. In Wheeler, Oregon.

Q. By whom are you presently employed?

A. By the State of Oregon.

Q. In what capacity?

A. In the State Unemployment Compensation Commission.

Q. Have you ever been a stockholder of the defendant Sutherlin Plywood Corporation?

(Testimony of Harold Hamby.)

A. I have.

Q. How much stock did you own in that corporation?

A. I have one working share of \$2,000 and \$40 of regular stock.

Q. Have you ever been an officer or director of that corporation?      A. No.

Q. Were you ever employed by that corporation? [122]      A. I was.

Q. In what capacity?

A. As office manager.

Q. During what period of time?

A. From July, 1953, to June, 1954.

Q. What were your duties as office manager, generally speaking?

A. To see that the proper records were kept and the functions of the office carried on.

Q. Did you have any duties as far as the accounting procedures were concerned?

A. I supervised them.

Q. Who actually did the accounting?

A. They were done by Grant Ayot, who in turn worked under Ray Ward, who was a CPA with Goodnight & Ward, who set the books up.

Q. Did Grant Ayot work under your supervision as office manager?      A. Yes.

Mr. Yerke: Now, your Honor, we can, I think, have identified through this witness the ledger and the journal, if there is any question on those, and then we will be through with that. It will take just a minute.

(Testimony of Harold Hamby.)

The Court: Go ahead.

Q. (By Mr. Yerke): Did Grant Ayot maintain a journal of the business transactions of Sutherlin Plywood Corporation? [123] A. Yes.

Q. Have you ever seen that journal?

A. I have.

Q. Did he make entries in the same under your supervision? A. He did.

Q. You have been handed, Mr. Hamby, what has been marked as Defendants' Exhibit 132-A for identification. Can you identify the same?

A. This is the journal of Sutherlin Plywood Corporation.

Q. Is that the journal that was maintained by Grant Ayot under your supervision?

A. It is.

Q. Did Grant Ayot also maintain a ledger while you were employed by Sutherlin Plywood Corporation? That question calls for a Yes or No answer.

A. Yes, he did.

Q. Was that ledger maintained under your supervision? A. Yes.

Q. You are familiar with the ledger?

A. I am.

Q. You have been handed what has been marked as Defendants' Exhibit 132-B for identification. Can you identify the same?

A. This is the ledger of Sutherlin Plywood Corporation.

Q. By "this" you are referring to Defendants' Exhibit 132-B? A. I am. [124]

(Testimony of Harold Hamby.)

Mr. Yerke: We renew our offer with respect to these two particular exhibits, your Honor, for the purpose of the record.

The Court: Any objection?

Mr. Anderson: I don't know what purpose they have. I don't believe that those are the documents that were identified. I am objecting to them. There has been no showing of any materiality of those documents.

Mr. Yerke: They will support the counterclaim that we have set forth in the answer, your Honor. They are the basic documents.

The Court: You are offering them in order to prove a claim?

Mr. Yerke: Beg pardon?

The Court: You are offering them to prove a claim?

Mr. Yerke: We offer them as the foundation documents in connection with the counterclaim. We are also offering them in connection with the financial condition of the corporation as displayed by the books.

The Court: Isn't it required that you show the books were kept in the regular course of business?

Mr. Yerke: I can ask him that, your Honor.

The Court: And whether they were correctly kept as far as he knows. Do you waive that?

Mr. Anderson: I waive that, your Honor. If I knew specifically what he was getting at there might be no objection, but I don't know what the

(Testimony of Harold Hamby.)

whole book is supposed to show. I don't [125] know how this supports the counterclaim.

Mr. Yerke: The counterclaim, Mr. Anderson, as you know from our conferences, involves a number of the transactions between Oregon Plywood Corporation, Oregon Plywood Sales Corporation and Sutherlin Plywood Corporation, such matters as the invoices or orders from Oregon Plywood Sales Corporation, the veneer purchases, the credits to be applied on one as against the other. These are the foundation documents which we need for that particular purpose. We intend to call the certified public account who set up the accounting procedures upon which these particular instruments were prepared, and then he will testify——

The Court: If it is just a matter of computation, that is one thing. But if the items are disputed, the mere fact that they made an entry wouldn't tend to prove or disprove any issue. For example, on the question of the \$336 that the plaintiff is claiming, if you had the item in here or didn't have it—if you had it, of course that might be an admission that you recognized the item. But if you contended that Oregon Plywood Sales owed you \$500 on a certain transaction and you had it down in the books, what would that tend to prove?

Mr. Yerke: I don't see how we could go ahead without having these in. It seems to me it is probative on that point.

The Court: I am going to admit them, but I am



(Testimony of Harold Hamby.)

going to admit them tentatively. Then we will see what happens with [126] the testimony.

Mr. Yerke: All right. Fine, your Honor.

(The journal and ledger above referred to were received in evidence as Defendants' Exhibits 132-A and 132-B, respectively, subject to the Court's qualification as stated above.)

Q. (By Mr. Yerke): You have been handed what has been received in evidence as Defendants' Exhibit 116, Mr. Hamby. Have you ever seen that instrument before? A. I have.

Q. Were you present when that was executed?

A. I was.

Q. Where was that executed?

A. In the office of Sutherlin Plywood Corporation.

Q. When was it executed?

A. So far as I know, it was in April.

Q. April of 1954? A. Right.

Q. Who was present at the time it was executed?

A. Grant Ayot, the bookkeeper, Marvin Steinbach, the secretary, myself, and Robert Hofheins.

Q. Who requested that this document be executed? A. Robert Hofheins.

Q. At the time that it was executed was there any discussion [127] among the group that you have named as to whether or not that particular instrument was for payment of the amount involved in these assigned accounts or was it for collateral security?

(Testimony of Harold Hamby.)

to the payment of said advance of \$11,000.00 There is no agreement on the second assignment.

The Court: It is a very unusual transaction, Mr. Yerke, for someone to take an assignment of a larger amount in payment of a smaller amount.

Mr. Yerke: I think we owed more at that time than \$12,000, your Honor. That is what it amounts to. The actual amount I don't know offhand, and apparently the witness doesn't. But the amount that we owed was in excess of \$12,000. I can show that through the accountant.

The Court: You say that there was nothing said about what would happen—let me hear your testimony again as to what was said with reference to this assignment.

A. It was taken in lieu of payment of the veneer in these orders.

The Court: That doesn't mean anything to me.

Q. (By Mr. Yerke): How did this come up, Mr. Hamby? What gave rise to this particular transaction?

A. In this particular instance there was a board meeting prior [130] to this, and Mr. Hofheins got up the next morning and went down to Multi-Ply Plywood Corporation without authority from anyone so far as we could find out, and he collected this \$4,000 check from them and brought it back to our office and demanded that this assignment be executed.

Q. What happened to the check?

A. That was in turn given to us provided we

(Testimony of Harold Hamby.)

reissue a check for the same amount to Mr. Hofheins, which we did.

Q. Is that \$4,000 figure shown on the bottom of Exhibit 116?      A. It is.

Q. Do you recall the amount that was due and owing to Oregon Plywood Sales Corporation for the veneer from which the plywood was manufactured that is referred to on these four invoices covered by the assignment?      A. I don't recall it.

Q. Do you recall the outstanding amount that was due and owing to Oregon Plywood Corporation for veneer at that particular time, veneer purchases?      A. No, I wouldn't recall.

Q. During the time that you were employed by Sutherlin Plywood Corporation did that corporation experience any difficulty in meeting its payroll?      A. We certainly did.

Q. On how many occasions?

A. On two different occasions. [131]

Q. When was the first occasion?

A. The first occasion was at the time we asked for the other \$30,000 on the open end mortgage. The exact date I am not positive of.

A. Those funds were forthcoming, were they?

A. They came in two different payments. We called Oregon Plywood Sales Corporation and Franklin Hofheins answered the phone, and he advanced, I believe, something like \$11,000.

Q. Then what was the second occasion when you encountered difficulties in meeting the payroll?

A. The second occasion was after we had stopped

(Testimony of Harold Hamby.)

production, immediately following the stoppage of production.

Q. What payroll were you concerned about then?

A. For the two weeks' period at the termination of production.

Q. Were you able to raise funds to cover that payroll?

A. Only by selling on the outside to different jobbers, was the only way we could raise any funds to meet that payroll.

Q. Were you ever threatened with labor liens while you were office manager?

A. We were on that particular occasion.

Q. Was there ever any difficulty in meeting insurance premium payments on the plant and property?

A. There was.

Q. When was that?

A. That was in June. [132]

Q. Of 1954?

A. The latter part of May or the first part of June.

Q. Of 1954?           A. Of 1954.

Q. How were those premium payments met then?

A. Mr. Petherick guaranteed payment, and he was practically forced to make it, but we negotiated with Multi-Plyd on a car of plywood and got the money to cover that payment.

Q. You apparently were in the office from the time the mill shut down until sometime in early

(Testimony of Harold Hamby.)

June; is that right?      A. I was.

Q. Did you have any contact with the creditors of Sutherlin Plywood Corporation?

A. Creditors sent me telegrams, long distance calls, registered letters, and so forth, demanding payment.

Q. Was that fairly continuous during that period of time?      A. All the time.

Q. Did you personally ever participate in any attempts to reopen the mill after it shut down on April 21st, 1954?

A. We did. We had meetings and we attempted to open, but we just couldn't raise the funds any place.

Q. Did you yourself ever find a source of green veneer for the mill?      A. I did.

Q. Where was that? [133]

A. At Brookings, Oregon, at the Kedrick plant.

Q. Were you ever able to obtain that veneer?

A. No.

Q. Why not?

A. We didn't have any funds.

Mr. Yerke: That is all.

#### Cross Examination

Q. (By Mr. Anderson): Mr. Hamby, were any labor liens ever filed?      A. No.

Q. Now Mr. Hamby, about these assignments, isn't it true that on the first assignment there was an excess collected and credited to Sutherlin Plywood by Oregon Plywood Sales Corporation?



(Testimony of Harold Hamby.)

A. I believe that is right.

Q. You felt you were entitled to that?

A. Yes.

Q. What is the difference, if any, between the first assignment and the second assignment?

A. I would have to read them to answer that question.

The Court: He has already said that one is accompanied by a memorandum of the understanding.

The Witness: That is right.

Q. (By Mr. Anderson): Were there any different terms in the two assignments? [134]

The Court: You can stop right here. I am in favor of you on this issue so far.

Mr. Anderson: All right.

Q. Mr. Hamby, did I understand you to say you found a source of green veneer at Kedrick's plant in Brookings? A. I did.

Q. What was the reason you didn't buy it?

A. We had no funds.

Q. Now who paid for the green veneer?

A. Oregon Plywood Sales.

Q. It didn't make any difference, then, whether you had any funds or not?

A. It made a difference if we had no glue or any supplies to lay it up with.

Q. But as far as paying for it—

A. No means of supplying glue or paying labor to lay it up or process it.

Q. The lack of funds didn't prevent you from buying veneer?

(Testimony of Harold Hamby.)

A. Not from buying veneer, no.

Q. All right. Mr. Hamby, what kind of management did Sutherlin have?

A. There you are putting me on the spot.

The Court: Go ahead and say.

A. I think Sutherlin had good management, but they were just short of working capital. [135]

The Court: Is the management an issue raised in this? What number is that contention? What contention are you referring to?

Mr. Yerke: I don't believe there is any.

Mr. Anderson: No, we have made no—

The Court: What are you bringing it in for, then? I would like to ask you a question, Mr. Anderson. Are you contending in this case that Sutherlin had plenty of money to operate, that they were not in danger of any liens being filed, and that they were not requested to pay their bills? Is that your contention?

Mr. Anderson: I don't doubt but what they were in serious financial difficulty, your Honor.

The Court: Then what do you ask this witness this ridiculous question for?

Mr. Anderson: I think there may be some question about why they were in that situation.

The Court: That is not an issue in this case. You didn't raise it.

Mr. Anderson: I think the defendant has attempted to raise the issue about their condition.

The Court: Yes, but he raised the issue that they were losing money every month and that they sold

(Testimony of Harold Hamby.)

the plant because they didn't want to suffer any more losses and they couldn't open up because they didn't have the money with which to open up. [136]

Mr. Anderson: Frankly, I don't think that is any defense.

The Court: That might not be.

Mr. Anderson: But if it is, I think we should be entitled to show why they were in that situation, whether it was their fault or the plaintiff's fault or somebody else's fault.

Mr. Yerke: I think, your Honor, that it could only be material, the reason why would be material, if they could show that we shut down, lost working capital and suffered losses as matters of bad faith. Otherwise it is not germane to the issues here.

The Court: You had Mr. Hofheins on the stand. He didn't testify that he told them to fire this manager. He didn't state that the manager was driving the plant out of business.

Mr. Anderson: The reason I didn't put it on at that time, your Honor, is because I thought this was part of the defendants' attempted explanation of why they didn't perform. As I understand it, they are making the contention that they had some reason for not performing. They talked about this lack of financing. No. 3-C, your Honor, under the defendant Sutherlin's contentions, they say it was made necessary by the poor financial condition of the defendant Sutherlin.

The Court: How long will it take you to go into that question?

(Testimony of Harold Hamby.)

Mr. Anderson: Just a few minutes. I have a few questions I would like to ask this man since he is going to leave, as I [137] understand it, and wants to go back to his work.

The Court: All right. I have grave doubts as to the admissibility, I am telling you, but because I am letting in most of the evidence I am going to let this in also.

Q. (By Mr. Anderson): Mr. Hamby, first about the management. What kind of a manager did Sutherlin have?

A. Well, he was a man who wanted to carry the whole load himself—I will be frank with you—and not delegate too much power to others.

The Court: What was his name?

A. But he was a good plywood man. N. L. Patterson was his name.

The Court: What?

A. N. L. Patterson.

Q. (By Mr. Anderson): Now Mr. Hamby, did Mr. Patterson do a good job for Sutherlin?

A. I think he did the best he could under the circumstances.

Q. Could someone else have done a better job?

A. Perhaps. That is something I can't answer truthfully. I don't know.

The Court: I will assume that there is somebody in the world that could have done a better job.

Q. (By Mr. Anderson): Mr. Hamby, what was the monthly payroll of Sutherlin?

A. I don't just remember offhand. [138]

(Testimony of Harold Hamby.)

Q. Approximately?

A. I think around \$27,000, or something like that—twenty-seven or twenty-eight thousand.

Q. Do you know of any practices in the mill which were not as they should have been?

A. There was one particular practice I would like to bring out, or one particular incident that I happened to be sitting in on in N. L. Patterson's office when Franklin Hofheins contacted him on the phone, as Robert Hofheins testified, where he advised him to stock up on veneers. And he bought high-priced veneers. It naturally was up at that time. Then the market dropped. And we had veneer stacked every place in the yard that it was feasible to stack it. And we suffered some loss because it was stacked outside in the sun and the weather, and then the price skidded and went down on the manufactured product, and we were stuck with all this high-priced veneer.

Q. You are talking about stocking up in anticipation of the strike?      A. That is right.

Q. You never did get a stockpile of veneer, did you?      A. We certainly did.

Q. How was the quality control in the mill?

A. State that question again.

Q. How was the quality control? Do you understand?      A. I don't understand your phrase. [139]

Q. Was all the veneer used in the best place for that quality of veneer?

A. It was to the best of my knowledge.



(Testimony of Harold Hamby.)

Q. How did Sutherlin happen to lose all this money? What was the reason for it?

A. What was the reason?

Q. Yes.

A. Because we were manufacturing with high-priced veneers and the price went down, and by the time we paid the five, five and two discounts we were operating at a loss.

The Court: What do you mean, five, five and two? Where was the second five?

A. One is the conventional discount——

The Court: What kind of discount?

A. One that the trade gives, and then there was the 5 per cent for the sales commission and then the 2 per cent, of course, for cash.

The Court: Every plant has at least five and two, don't they? A. That is right.

Q. (By Mr. Anderson): Mr. Hamby, were you critical of Mr. Patterson?

A. There were some practices that I didn't exactly approve of, yes.

Q. I tried once before to get your opinion on it and I will [140] try once more. Weren't there quite a number of practices which you thought should not have been engaged in by the manager?

A. Now what do you mean by quite a number?

Q. Just answer the question the best you can.

A. I told you that there were practices that I didn't approve of. I won't go so far as to say there were quite a number, because I liked the man.

Mr. Anderson: All right. That is all.

Mr. Yerke: No further questions.

(Witness excused.) [141]

MARVIN D. STEINBACH

was produced as a witness in behalf of the Defendants and, having been previously duly sworn, was examined and testified as follows:

Direct Examination

The Court: Mr. Anderson, so that we can save time on cross examination, I am going to tell you that I am going to assume that Mr. Patterson was not the best plywood superintendent or manager that they could have obtained.

Mr. Anderson: All right, your Honor.

The Court: In all the cases that have come here I don't know of one in which there wasn't a complaint about the plywood management. Every cooperative that comes into this court, whether they go into bankruptcy or Chapter 11, or are just sued, somebody is complaining about the management. So I am going to assume that there were complaints about Mr. Patterson and that some of these complaints were valid.

Mr. Anderson: All right.

Q. (By Mr. Yerke): Mr. Steinbach, you are Secretary of Sutherlin Plywood Corporation?

A. I am.

Q. You have been Secretary since the organization of that corporation? A. I have.

Q. You are also a stockholder? [142]

A. That is right.

(Testimony of Marvin D. Steinbach.)

Q. Did you attend a meeting at Sweet Home that Mr. Hofheins testified about yesterday?

A. I did.

Q. That was in November of 1953?

A. The latter part of November; yes, sir.

Q. At that meeting did you hear anyone represent that Sutherlin Plywood Corporation would engage in continuous operation? A. No, sir.

Q. Defendants' Exhibit 134-A is the minutes of a special meeting of the Board of Directors of December 6, 1954, at the Eugene Hotel. Do you recall attending that meeting?

A. What was the date again?

Q. December 6th, 1954. A. Yes, sir.

Q. Was Mr. Hofheins at that meeting?

A. Yes, sir.

Q. Was there anyone else present at the meeting besides the Board of Directors of Sutherlin and Mr. Hofheins? A. Not that I recall.

Q. Now at that particular meeting were any documents presented for consideration by the Board of Directors? A. No, sir.

Q. No documents were presented? A. No.

Q. There were no documents considered at that time?

A. Yes, there were some that Mr. Hofheins had brought.

Q. What documents were those?

A. There was a rough draft of the sales agreement.

Q. Was that agreement executed at that time?

(Testimony of Marvin D. Steinbach.)

A. It was not.

Q. Why not?

A. There were several changes that had to be made that we couldn't agree on. I mean the original draft was presented by Mr. Hofheins.

Q. I notice that at the meeting of the board on that particular date that a resolution was passed authorizing the execution of the sales agreement. What agreement was that?

A. Well, that was the agreement after the changes had been made in the rough draft that Mr. Hofheins had brought.

Q. But the agreement was not executed after the changes had been made?      A. No, sir.

Q. What happened to the agreement?

A. Mr. Hofheins said that he had to get his board of directors' okeh on it before he could sign it, and the Sutherlin board wanted to peruse it a little further themselves.

Q. Had a note and mortgage been prepared at that time?      A. No, sir.

Q. Who prepared the note and mortgage, if you recall? [144]

A. Mr. Hoffman, who was Sutherlin's lawyer.

Q. Had he prepared it by the time of that meeting?      A. No, sir.

Q. Now Defendants' Exhibit 134-I is a certificate concerning some resolutions passed at a meeting on December 12, 1954. Where was that meeting held?

(Testimony of Marvin D. Steinbach.)

A. That meeting was held in the offices of Sutherlin Plywood Corporation.

Q. Were you present at that meeting?

A. I was.

Q. Now that meeting refers to executing the mortgage, sales agreement and the loan agreement. Do you recall those instruments? A. Yes, sir.

Q. What sales agreement was authorized for execution at that meeting?

A. The sales agreement that had been agreed upon by our attorney, Mr. Hoffman, and by the board.

Q. Now, going back to the meeting of December 6th, did anyone at that meeting, to the best of your recollection, represent that Sutherlin Plywood Corporation would engage in continuous operation?

A. No, sir.

Mr. Anderson: Is that the Sweet Home meeting?

Mr. Yerke: No, the meeting of December 6th, 1954, in the [145] Eugene Hotel, which is referred to in the minutes about which he has been testifying.

Mr. Anderson: Is this the Eugene meeting we talked about all day yesterday?

Mr. Yerke: Our position is there were two Eugene meetings. Mr. Hofheins recalls only one. I am speaking now of the meeting of December 6th, 1954. The minutes which you examined, Exhibit 134-A, recite what occurred at that meeting.

Q. (By Mr. Yerke): Was there another meet-



(Testimony of Marvin D. Steinbach.)

ing at the Eugene Hotel later in the month of December?      A. There was.

Q. And the documents in question here recite that they were executed on December 17th, 1954. Was that the date of the meeting?      A. That was.

Q. Did Mr. Hofheins attend the meeting?

A. He did.

Q. Who else attended the meeting on behalf of Oregon Plywood Sales Corporation or Oregon Plywood Corporation?

A. Mr. Swan and I believe Mr. Sadoff was there.

Q. Mr. Swan was the attorney, was he not?

A. That is right.

Q. For Oregon Plywood Corporation?

A. That was our understanding.

Q. At that meeting was there any representation made that [146] Sutherlin Corporation would engage in continuous operation of its mill?

A. No, sir.

Q. Were the documents executed at that particular meeting?      A. They were.

Q. Do you recall any particular instances, Mr. Steinbach, when the mill after it commenced operating had difficulty meeting payrolls?

A. Yes, I do.

Q. In how many instances?

A. I would say two or three.

The Court: There has been no dispute about that.

Mr. Yerke: All right. We won't put on any further testimony, your Honor, on that point.

(Testimony of Marvin D. Steinbach.)

The Court: That evidence came out in the plaintiff's case in chief on two occasions, that they had difficulty in meeting the payroll.

Q. (By Mr. Yerke): Now, Exhibit 134-C, Mr. Steinbach, which has been received in evidence, is a copy of the minutes of the Board of Directors' meeting of March 27th, 1954. Did you attend that meeting? A. I did.

Q. You prepared the minutes of that meeting, did you not? A. Yes, sir.

Q. Was Mr. Hofheins present at that meeting?

A. I don't recall. What was the date again?

Q. March 27th, 1954.

A. Yes, he was there March 27th.

Q. Now those minutes recite, Mr. Steinbach, that the board advised Mr. Patterson, the General Manager, to cease all purchases of veneers and to operate until the present stock was exhausted. Why was that, if you recall?

A. Because our yard was full of veneers. They had been stocked up by Mr. Patterson, and our capital was exhausted, our working capital was exhausted, and we didn't want to endanger our stockholders any further than they were.

Q. Did Mr. Hofheins object to these directions to Mr. Patterson? A. No, sir.

The Court: Did what?

Mr. Yerke: Did Mr. Hofheins object to these directions to Mr. Patterson. The answer was No.

The Court: What date is that?

Mr. Yerke: That is March 27th, 1954.

(Testimony of Marvin D. Steinbach.)

Q. At that meeting was there any discussion concerning shutting down the plant?

A. Not that I recall.

Q. Now you recall the date the plant shut down, do you not, Mr. Steinbach?

A. It was April the 21st.

Q. 1954? A. 1954. [148]

Q. Why did the plant shut down?

A. Our working capital was completely exhausted. We were threatened with labor liens and our power had been shut off.

Q. Did you personally after the plant was shut down make any efforts to assist in reopening the plant? A. I did.

Q. What did you do?

A. Alone and in company with Mr. Petherick and other members of the board I visited the local bank, Mr. Clem Howard is the manager, trying to get an additional loan so we could have working capital to go ahead and open up the plant. We were unsuccessful. We also went to the United States National Bank in Roseburg and were unsuccessful there. Both bankers, Mr. Small, of the U. S. National Bank in Roseburg, and Mr. Howard from the Sutherlin Branch of Douglas County State Bank, both told us that they didn't think it would be possible for us to get a loan from any other bank.

Q. Did you personally try to sell any additional stock in the corporation? A. I did.

Q. Were those efforts successful? A. No.

(Testimony of Marvin D. Steinbach.)

Q. Did you contact any plywood plants in an attempt to get refinancing? A. Yes. [149]

Q. Will you name some of those plants.

A. Aetna Plywood, Multi-Plyd, M & M Plywood, I believe, and Colorado Fuel——

Q. That is enough. Now you mentioned that the power was shut off on or about April 21st, 1954. Why was it shut off?

A. For nonpayment of the bill.

Q. Was a watchman maintained at the plant after the plant was shut down? A. Yes.

Q. Did you encounter any difficulty in paying him? A. We did.

Q. Did you personally assist in making payments to him? A. I did.

Q. What did you do?

A. I contributed \$200 towards the payment for the watchman's wages.

Q. There has been testimony here, Mr. Steinbach, you were present at the time that Defendants' Exhibit 116 was executed. Were you present when that particular instrument was executed?

A. I was.

Q. Where was it executed?

A. In the office of Sutherlin Plywood Corporation.

Q. Who was present? [150]

A. Mr. Hamby, Mr. Ayot, Mr. Hofheins and myself.

Q. Do you recall the circumstances under which it was executed? A. I do.

(Testimony of Marvin D. Steinbach.)

Q. What were those circumstances?

A. As related by Mr. Hamby, Mr. Hofheins had collected that \$400 check from Multi-Plyd——

Q. You mean \$4,000?

A. \$4,000, rather, and came to the office and demanded that we deposit that and immediately give him a check covering the same and that we give him an assignment on the balance on these invoices that had been sent as outlined in this assignment.

Q. Was there any discussion, Mr. Steinbach, to the best of your recollection, as to whether or not the assignment was for payment of the amounts due or whether it was for security, if you recall? That calls for a Yes or No answer. Was there any discussion?

A. Yes, I believe there was.

Q. What was that discussion, as best you can recall?

The Court: You tell me what Mr. Hofheins said and what you said or what some other people said, as best you can recall it.

A. Well, I don't recall the exact words, but to the best of my recollection I think we insisted that this assignment was for payment of the account to be credited——

Mr. Anderson: I object, your Honor. I [151] want the witness to testify what they said and who said it.

The Court: How did that happen to come up? Did you have a discussion as to whether this was



(Testimony of Marvin D. Steinbach.)

going to be for security or for payment? Did Mr. Hofheins say this was merely for security, and some one of your group said, "No, this is going to be in full payment; if you take this assignment it is in payment and you take your chances"? Was anything like that said?

A. As I recall, Mr. Hofheins said that he wanted it in for collateral, and we insisted that it be for payment.

The Court: Why did you insist that it was payment rather than as collateral? What was the basis of that?

A. Because he had already on his own collected the \$4,000.

The Court: That was only \$4,000. What difference would it have made as to the \$4,000 if he had already collected it or hadn't collected it?

A. We contended that if he had taken it upon himself to collect the \$4,000 he considered that the accounts were his.

The Court: And you told him so at the time?

A. I believe we did; yes, sir.

The Court: You are not just figuring these things out now a couple of years later?

A. No, sir.

The Court: How about the previous one of April 6th?

A. That was for collateral, I believe, because it stated so in the exhibit. [152]

The Court: You didn't think to prepare another memo to say that even though the April 6th

(Testimony of Marvin D. Steinbach.)

assignment was for collateral this one was in full payment?      A. No, sir.

The Court: And it was your understanding that if he collected any overplus that belonged to him?

A. Well, it was to be credited to our account.

The Court: Did you know at that time that the Coastal Lumber Company was in financial difficulties?      A. No, sir.

The Court: Why did you insist, then, that the amount be accepted by Mr. Hofheins in full payment rather than as collateral?

A. Because we wanted our accounts to be brought up to date.

The Court: All right.

Q. (By Mr. Yerke): Did you work in the office there, Mr. Steinbach?      A. I did not.

Q. Do you recall who prepared the earlier assignment of April 5th?      A. No, I do not.

Q. Now do you recall a meeting of the creditors of Sutherlin Plywood Corporation in June of 1954?

A. Yes, sir.

Q. Did you attend that meeting? [153]

A. I did.

Q. What happened at that meeting?

A. Notices had been sent out to all the creditors of Sutherlin Plywood Corporation, and they met in the offices of the plant, and at that meeting a creditors' committee was formed after the financial conditions of Sutherlin had been explained to them.

The Court: What date was that?

Mr. Yerke: That was early June, I believe.

(Testimony of Marvin D. Steinbach.)

Let's see. I can get it from the witness.

Q. Did you prepare the minutes which are Defendants' Exhibit 134-D, minutes of June 7th, 1954?

A. I did.

Q. Those minutes, Mr. Steinbach, referred to the calling of a meeting of creditors of June 11th, four days later. Was that the date of the meeting of creditors?

The Court: June 12th.

Mr. Yerke: That is the stockholders, your Honor. June 12th is the stockholders.

The Court: Oh.

A. Yes, sir.

Q. (By Mr. Yerke): The creditors, then, met on June 11th in accordance with this resolution?

A. That is right.

Q. Now at this meeting of creditors was [154] there any discussion of the sale or lease of the assets of the corporation? A. No, sir.

The Court: Do you have the minutes of the meeting of creditors?

Mr. Yerke: There were no minutes kept, your Honor, as far as I know. At least, they are not in the minute book.

The Court: Who was represented among the creditors?

A. Sutherlin Machine Works, Mr. Conway from the Coe Manufacturing Company, and someone from—I believe it was the Marietta Glue Company, and Mr. Lee from the Union Oil Company. That is all I recall right now.

(Testimony of Marvin D. Steinback.)

Q. (By Mr. Yerke): How many creditors were there, if you recall?

A. There was around ten or eleven. I don't remember. I was also there as a creditor, your Honor.

The Court: Was Mr. Hofheins there as a creditor? A. I don't believe that he was.

The Court: You don't believe he was?

A. No.

Q. (By Mr. Yerke): There has been admitted in evidence, Mr. Steinbach, Defendants' Exhibit 134-E, which is a special meeting of the stockholders on June 12th, 1954. Did you attend that meeting? A. I did.

Q. That was a day after the creditors' meeting?

A. That is right. [155]

Q. Were there any creditors present at that meeting? A. A few; yes, sir.

Q. Up to that point had there been any threats of litigation by creditors? A. Yes.

Q. Were you having any difficulty with the watchman at that time because of his wages?

A. Yes, we had a threat of lien, wage lien.

Q. Now that particular exhibit, 134-E, Mr. Steinbach, refers to a resolution which is as follows: "That the Board of Directors negotiate to dispose of the plant or to get refinancing or to dispose of the situation as is in their estimation to the best interests of the stockholders." Do you see that in the minutes? A. Yes, sir.

Q. Up to that point had the directors and officers

(Testimony of Marvin D. Steinbach.)

of Sutherlin Plywood Corporation made any attempt to sell or lease the assets of the corporation?

A. No, sir.

Q. Now, in connection with this authorization of sale which is recited in these minutes, did you personally contact any attorneys concerning the effect of the sales agreement upon the sale?

A. I did.

Q. What attorneys did you contact? [156]

A. I contacted Mr. Ray Compton in Roseburg, and he referred me to Mr. George Luoma.

Q. That is Mr. George Luoma sitting next to me?

A. Yes, sir.

Q. Who else did you contact?

A. Carl Francis in Dayton, Oregon, and also Mr. Theodore Bloom in Portland.

Q. What question did you pose to Mr. Francis?

A. I asked him if the contract with Oregon Plywood Corporation or Oregon Plywood Sales Corporation was binding upon Sutherlin in the event that a sale of the assets was made.

Q. Were you given advice by Mr. Francis?

A. Mr. Francis advised us that in his estimation the contract would not be binding upon any purchaser.

Q. Was that advice given—

Mr. Anderson: If the Court please, I object and ask that the answer be stricken as hearsay.

Mr. Yerke: We offer it on the same basis as previously tendered, your Honor.

The Court: Just to show good faith?



(Testimony of Marvin D. Steinbach.)

Mr. Yerke: That is right.

The Court: Just to show good faith.

Mr. Anderson: It still is hearsay, your Honor. Mr. Francis is not very far away. He can be brought here.

Mr. Yerke: You bring him then, Mr. Anderson.

The Court: All right. Objection overruled. I really don't think it is necessary.

Mr. Yerke: All right. I won't go into it any further. It was just that one issue we were concerned about, your Honor.

The Court: There is no evidence here as yet anyway that there was any bad faith on the part of the directors of this corporation in selling. If there is, I haven't heard it. Maybe they are going to put in such evidence, but this is an anticipatory defense.

Q. (By Mr. Yerke): Now did you attempt to sell the assets personally of Sutherlin Plywood?

A. Mr. Wood, Mr. Petherick and I approached several plywood plants trying to sell it to them, or brokerage houses.

Q. Now Exhibit 134-F, Mr. Steinbach, is admitted in evidence. That is the minutes of a special meeting of the Board of Directors on July 28th, 1954. Do you recall that meeting? A. I do.

Q. Mr. Hofheins attended that meeting, did he not? A. He did.

Q. Do you recall a resolution that was passed at that meeting concerning the sale or lease of the assets of the corporation? A. I do.

(Testimony of Marvin D. Steinbach.)

Q. Do you recall when that resolution was voted on, Mr. Steinbach? A. I do. [158]

Q. How did Mr. Hofheins vote?

A. Mr. Hofheins didn't vote for it or he didn't vote against it.

Q. Did he raise his hand? A. He did not.

Q. Did he say anything? A. He did not.

Q. Did he discuss at all the advisability of the sale or lease of the assets of the corporation?

A. After the vote had been taken Mr. Hofheins said that that was the only thing that was left for us to do.

Q. And at that meeting were any of the pending deals for the sale or lease of the assets outlined to the directors? A. They were.

Q. Did Mr. Hofheins object to any of those deals as outlined? A. No, sir.

The Court: Before the vote was taken did Mr. Hofheins announce that the purchaser would be bound by the contract?

A. Not that I recall, sir.

The Court: Did he say that you couldn't dispose of the plant because of the contract with Oregon Plywood Sales?

A. I don't recall that he did. Otherwise he would have voted against it.

Q. (By Mr. Yerke): Did he threaten a lawsuit at the time? A. No, sir. [159]

Q. At that meeting you also passed a resolution calling another directors' meeting for August 9th, 1954, did you not? A. Yes, sir.

(Testimony of Marvin D. Steinbach.)

Q. Was Mr. Hofheins present when that resolution was passed? A. He was.

Q. Now Exhibit 134-G, Mr. Steinbach, is the minutes for the stockholders' meeting of August 9, 1954. Do you recall attending that meeting?

A. Stockholders' meeting?

Q. Yes, of August 9, 1954. A. Yes, sir.

Q. You did? A. Yes.

Q. Did Mr. Hofheins attend that meeting?

A. No.

Q. Following that meeting was there a special meeting of the Board of Directors?

A. There was.

Q. Did Mr. Hofheins attend that meeting?

A. No.

Q. Up to that point had any protest been received from Oregon Plywood Sales Corporation concerning the contemplated sale or lease of the assets of the corporation?

A. Not to my knowledge.

Q. Now following the meeting of the Board of Directors of [160] August 9, 1954, did the directors advise Adams and Jacobson that the plant would be sold to them? A. Yes.

Q. Have you ever been paid any compensation as an officer or director of Sutherlin?

A. I have not.

Q. Have any of the other officers or directors been paid any compensation? A. No, sir.

The Court: Are you the man that is a truck driver?

(Testimony of Marvin D. Steinbach.)

A. Yes, sir. Rather, I am a trucker, your Honor, not a truck driver.

The Court: You are a trucker. You own the truck? A. Yes.

The Court: Sometimes there is no distinction.

Q. (By Mr. Yerke): One other question, Mr. Steinbach. At the meeting at Sweet Home with Mr. Hofheins did you furnish to him or did one of the directors furnish to him a financial statement of the corporation; that is, including a balance sheet?

A. Yes. I believe the balance sheet was as of October the 31st, 1951.

Q. You mean 1953? A. '53, yes.

Q. Who had prepared that, if you recall?

A. Stearns & Flynn, I believe. [161]

Q. You have been handed what has been received in evidence as Defendants' Exhibit 131-A, Mr. Steinbach. Is that a copy of the statement that was furnished Mr. Hofheins at that time?

A. I would say that it is; yes, sir.

Mr. Yerke: No further questions.

The Court: I am convinced on the basis of the testimony now that the company was in a difficult position at the time that they closed and that it could not meet its payroll; that they made attempts to refinance and could not refinance, and that they probably did all they could do in order to salvage what they had. On the basis of the testimony I have heard yesterday, even without seeing the financial statement, I am convinced that Mr. Hofheins

knew that he was not dealing with the United States Steel Corporation or the U. S. Plywood Corporation. He knew he was dealing with a company that was just getting started, with a considerable portion of the capital being put up by the people who were working in the plant, and that the officers of the corporation would be people who had limited experience in dealing with the operation of a plywood plant.

I am also convinced that one of the risks that a person takes when they deal with a company of that kind is the fact that they may not engage in a continuous operation. I don't doubt that these men all expressed the hope that they would be successful and be able to operate over a long period [162] of time. I think that the confidence of people of that kind, who entered into this arrangement, was much greater about the profit that they would make in the length of time that they would be able to operate than experienced people like Mr. Hofheins, who has seen companies come and go.

For that reason I am not impressed with any representations having been made of continuous operation, and even if such representations were made I can't believe that an experienced businessman like Mr. Hofheins would have relied upon that kind of a representation.

Likewise, I am not impressed with the defendants' testimony with reference to the assignment. Just as I think it flies in the face of human experience for Mr. Hofheins to rely on statements made by these people as to continuous operation, I



think it flies in the face of human experience for Mr. Hofheins to have accepted this type of assignment in full payment of the obligation. This has been a long time after the event, and I think that the desire to have it accepted in payment is the motivating cause for the testimony of some of these people. I am not accusing them of any deliberate intent, but the evidence that he accepted it as full payment is certainly unsatisfactory, and you will have to have some better type of testimony to make me believe that it was accepted for any other reason than as security. Of course, Mr. Hofheins was taking it in order to get paid, but he didn't [163] accept the invoices in payment. There is a real distinction between those two.

Now what consequences will flow from the remarks which I have made earlier I don't know. I don't know whether a company which has entered into the type of contract that the Sutherlin Plywood Corporation entered into can by shutting down avoid the consequences of their contract. I would be very much surprised if there was any liability on the Nordic Plywood Corporation, but I just don't know as far as Sutherlin Plywood is concerned.

Unless you want to put in evidence to corroborate the cumulative evidence to show good faith or financial inability, I don't think it is necessary. I mean unless the plaintiff has some evidence to show that these people acted capriciously or fraudulently. If you wanted to assert that claim, I don't know whether you could or not under the pretrial order. You have made no such contention.

I am not impressed, as I told you before, that the manager was not everything they had hoped for. Most of the plywood plants in this area haven't got good managers. That is the reason they fold up. That is the reason U. S. Plywood and all the rest of them make money and the rest of them don't make money. It is just a question of management.

I have unburdened myself as to how I feel. I have said these things in the hope that it might indicate what [164] additional testimony should be put on. Now if you have any evidence along these lines that you think I should hear, I will be glad to hear it, and then you can put on your other evidence. But the evidence in the plaintiff's case in chief was that they did not own the equipment. They were just buying the equipment on contract. That is not very much security. Go ahead.

Mr. Yerke: We have two other memoranda we would like to submit to the Court at this time on the issues involved, your Honor.

The Court: What are they?

Mr. Yerke: One is on the question of the alleged tort here by Nordic and the other is in connection with the argument of consideration, usury and the statute of frauds.

The Court: Oh, I am not interested in that. The statute of frauds, what has that got to do with this?

Mr. Yerke: I will defer to Mr. McClanahan on that.

Mr. McClanahan: If the Court please, the statute of frauds is only, so to speak, a tactical argument in this matter. We don't contend that it is going to be dispositive of the thing.

The Court: Going to be what?

Mr. McClanahan: Going to be dispositive of the matter, and in view of the plaintiff's case in chief it may be disregarded entirely. They have not contended, for instance, that there is any consideration for this sales agreement other than [165] what they said they were going to do and what is in the loan agreement. Now we submit that anything that is not in the loan agreement or in the note and mortgage or in the sales agreement cannot be shown as consideration for this because of the statute of frauds.

The Court: All right. What about usury?

Mr. McClanahan: The usury point, your Honor, we tried in this memorandum to show that there is absolutely no consideration for the extra 5 per cent, the 5 per cent over the wholesale jobber's price which the Oregon Plywood Sales Corporation was to get. There was absolutely no consideration for it other than the promises contained in the loan agreement. Now if that was a consideration——

The Court: Wait a minute. Let me see. You mean that the ordinary broker gets 5 per cent——

Mr. McClanahan: Here is the thing, your Honor: They didn't promise to buy a stick or a foot. That is the difference between this and many output contracts, your Honor.

Mr. Anderson: They promised to buy all the green veneer.

Mr. McClanahan: Just a moment. In the sales agreement—and that is why, I think, we have got to take these documents separately——

The Court: You mean to say that if they had agreed to buy all of the output then they would be entitled to 5 per cent, and this way they are not?

Mr. McClanahan: It is a matter of negotiations again. But here is the thing, your Honor——

The Court: Where did you get the authority on which you rely? Have you got any other contracts like this? I think your argument is just fantastic.

Mr. McClanahan: I would request the Court to consider the authorities and the usury section.

The Court: You know, if you would stick to the main issue instead of coming in on all the tangential issues these cases would go a lot quicker. Let me tell you something else as a matter of trial technique, just as a matter of friendly advice. If you would stop all this and stick to the main issue instead of going out on this assignment issue and things of that kind it would be a lot better. I think you have a good case. Why don't you stick to it?

(Thereupon a recess was taken until 1:45 o'clock P.M. of the same day, at which time Court reconvened and proceedings herein were resumed as follows:) [167]

### MARVIN D. STEINBACH

a witness produced in behalf of the Defendants, resumed the stand and was further examined and testified as follows:

#### Cross Examination

Q. (By Mr. Anderson): Mr. Steinbach, in all your negotiating with Mr. Hofheins for the ar-



(Testimony of Marvin D. Steinbach.)

arrangement which was finally culminated with the December 17th agreement, what did you represent in regard to how much money Sutherlin needed?

A. As nearly as I can recall, we requested \$100,000 from them, and they suggested that \$50,000 would be enough, and we finally settled on the \$80,000.

Q. What did you advise Oregon Plywood about your condition at that time, your financial condition?

A. I don't know as I understand your question.

Q. Did you advise Oregon Plywood Sales Corporation that with this \$80,000 you would be in a position to operate?

A. We advised them that we would be in a position to start operations and we hoped to continue.

Q. Mr. Steinbach, I believe you testified today you felt Sutherlin was not bound by the sales contract. Is that your present testimony?

A. I didn't hear you on account of the noise.

Q. Is it your testimony today that you do not consider the sales contract in force as to Sutherlin?

A. No, I think I testified yesterday that I considered that the sales contract was in force with Sutherlin as long as they were in production.

Q. As long as they owned the mill? A. Yes.

Q. Now you gave some testimony on your direct examination about some advice from lawyers that you had received. Didn't the advice from lawyers lead you to believe that the contract was in force?

A. The advice from the lawyers—the opinion



(Testimony of Eugene F. Cunningham.)

A. That is right.

Q. How long have you been Chairman of the board?

A. Since the inception of the company, since it was organized.

Q. Are you also a shareholder in that corporation?      A. I am.

Q. Have you done any work for that corporation as an employee other than serving as an officer and director?      A. No.

Q. Do you recall attending a Board of Directors' meeting at Sutherlin in March, 1954, March 27?

A. Yes, I do.

Q. Was Mr. Hofheins at that meeting? [172]

A. He was.

Q. Was there a discussion at that time about shutting down the plant?

A. A very extensive discussion.

Q. Did Mr. Hofheins object to that in any way?

A. No.

Q. Did he threaten a lawsuit?      A. No.

Q. Have you had any conversations over the telephone with Mr. Hofheins since the execution of the sales agreement on December 17th, 1953?

A. Yes, I had numerous conversations with him after that March 28th meeting?

Q. Since the March 28th meeting?

A. That is right.

Q. 1954?      A. That is right.

Q. Did you ever discuss with him the assignment of Western Door & Plywood Company invoices?

(Testimony of Eugene F. Cunningham.)

A. I didn't discuss the assignment; no, sir.

Q. Did you ever discuss with him an extension of time on those invoices?

A. We were negotiating relative to possible financing of the company, and I asked how he was getting along with the collection of those accounts because I was interested in seeing that he [173] did get his money as a matter of keeping things in good relationship between us.

Q. What did he advise you?

A. He remarked that he had extended the time and taken some notes from Mr. Morris of Western Door giving him additional time.

The Court: Was there any extension made on the Coastal account?

Mr. Yerke: No, your Honor.

The Court: What difference would that make?

Mr. Yerke: They are covered by the same assignment.

The Court: Yes, but if Western Door didn't pay then you could contend that the extension of time was a change in the obligation. But how are you going to claim any benefit from that? As I understood it, the Western Door paid their account.

Mr. Yerke: They ultimately did; that is right.

The Court: No claim is being made on Western Door.

Q. (By Mr. Yerke): Did you attend the meeting of the creditors down at Sutherlin on July 11th?

A. Yes, I did.

(Testimony of Eugene M. Cunningham.)

Q. Did you attend the shareholders' meeting the following day?      A. I did, sir.

Q. You recall the passage of that resolution authorizing the Board of Directors to dispose of the assets of the company, do you? [174]

A. Yes, sir.

Q. Did you ever seek legal advice concerning the right of Sutherlin Plywood Company to dispose of its assets?      A. Yes, I did.

Q. From whom?

A. Raymond D. Ogden, Sr., in Seattle.

Q. He is a lawyer practicing there?

A. That is right.

Q. What was the nature of the advice you sought from him?

A. I wanted to know what the situation would be in the event that we had to sell or lease our assets. We were in a desperate condition, and I felt it was necessary that we either sell or lease them, and I got his opinion relative to what the liability of Sutherlin would be in the event that we sold our assets.

Q. What was that opinion?

Mr. Anderson: If the Court please, I object to this testimony unless the opinion is produced or the witness is produced. I think the testimony of these witnesses has shown that the sum total of the opinions they got led them to believe the contract was in force. And I object to this hearsay testimony.

Mr. Yerke: We offer it on the same basis as the

(Testimony of Eugene F. Cunningham.)

other, your Honor. There is no written opinion.

The Court: I sustained the previous objection, and then you went into the whole question. You are the one that is bringing this up, Mr. Anderson. You asked the questions, and [175] then when they tried to bring it out with another witness you object.

Mr. Anderson: Your Honor, I went into what the opinion of the Board of Directors was. I did ask Mr. Steinbach in his deposition whether they had sought this type of advice and he said no; the type of advice they sought was what the effect would be on the purchaser.

The Court: Maybe Mr. Steinbach only asked for that advice, but here Mr. Cunningham goes further. I might say that really I am not interested in what Carl Francis or Ted Bloom or any of these lawyers gave as advice, really. That is for me to determine.

Mr. Yerke: We realize that. It is only on the matter of good faith, your Honor.

The Court: That is right.

Mr. Anderson: I make the further point, your Honor, that unless they show what the Board of Directors believed from all the advice they got this piecemeal material doesn't mean anything.

The Court: I think probably there is something in that. Was the question of the liability of the company discussed at a board meeting?

A. Oh, definitely.

The Court: And were these various opinions of lawyers discussed in the meeting? [176]

A. Yes, sir.

(Testimony of Eugene F. Cunningham.)

The Court: Was Mr. Hofheins there?

A. No, I don't believe he was at that time. I think most of this came up after the March 28th meeting.

The Court: At what meeting did it take place?

A. At the later meetings, when we were faced with the problem of either selling or leasing the property, about the time of the stockholders' meeting.

The Court: Did you report as to your conversations?

A. Oh, yes, and the other boys reported as to theirs also.

The Court: Tell us what took place at that meeting, at the board meeting.

A. There was a general discussion of the situation and what had to be done, and that we were facing desperate circumstances.

Mr. Anderson: May I ask which meeting we are discussing now?

The Court: There is the minutes of that meeting here in the file; that is, in evidence.

Q. (By Mr. Yerke): Which particular meeting now do you have in mind, Mr. Cunningham?

A. I think it would be about June, the general discussion.

Mr. Yerke: He is referring, I think to the stockholders' meeting of June 12th following the creditors' meeting. That is where the first resolution was passed on the matter of selling the assets. [177]

A. That is right; about that time. I believe Mr.



(Testimony of Eugene F. Cunningham.)

Hofheins was present at that meeting where there was a discussion.

Mr. Yerke: That is 134-E, your Honor.

The Court: It doesn't say anything about asking advice from lawyers.

The Witness: That is perhaps true, but it was discussed, I am sure.

The Court: All right. Go ahead.

Q. (By Mr. Yerke): Was Mr. Francis present at that meeting, if you remember?

A. He was at the stockholders' meeting; not at the directors' meeting.

Q. Did you get a written opinion from Mr. Ogden on the subject? A. No, I did not.

Q. Now following this meeting of June 12th, 1954, the stockholders' meeting, did you discuss the sale or leasing of the assets with John R. Adams?

A. Did you say after that meeting?

Q. Yes.

A. Yes. We were discussing the matter of whether we could work out some kind of a lease agreement.

Q. That is the same Mr. Adams who with Mr. Jacobson ultimately purchased the plant; is that right? A. That is right.

Q. Now do you recall the directors' meeting [178] Mr. Cunningham, of August 9th, 1954?

A. Yes, I do.

Q. Did you attend that meeting?

A. I did.

Q. At that meeting was there a discussion of

(Testimony of Eugene F. Cunningham.)

the deals then pending as far as the sale or leasing of the assets was concerned?      A. Yes, Sir.

Q. Were all of the pending deals considered at that meeting?

A. They were. There were three of them.

Q. All right. Will you tell the Court what those three deals were.

A. One of them was a sort of a cooperative and was in intangible form. It was from a man who had endeavored to organize a cooperative prior to that time. He did come over from the Coast and visited us once prior to that meeting, and he submitted in written form a proposition which we didn't consider of value.

We had another one from "Smoky" Johnson. I believe it is the Grants Pass Plywood; is that correct?

Q. I don't know.

A. I believe that is the same that his company goes under. Anyhow, "Smoky" Johnson. He called me on the telephone the morning of the 9th and advised me that he was finally able to go through a deal on the financing end of it; that he would be able to get the money and he gave me a figure [179] which was slightly higher than Mr. Adams' and Mr. Jacobson's figure. I laid that entire proposition in front of the board. I also put Mr. Adams' and Mr. Jacobson's proposition in front of the board. It was finally decided that, everything considered, we would be much more secure and the stockholders'

(Testimony of Eugene F. Cunningham.)

interests would be best served by accepting Adams' and Jacobson's offer.

Q. Why did you turn down Mr. Johnson's offer?

A. Because we felt there was some question as to whether he was able to get the money necessary and whether he would be able to get it in the time that it was necessary for us to act. Things were very pressing at the moment. We had little time to act, and otherwise we would have been in bankruptcy.

Q. Do you recall the amount of the offer by this cooperative or possible cooperative organization?

A. I don't at the moment, no.

The Court: I don't think that is necessary. There is no contention made here that they didn't take the best offer. It is just the fact that the offeree didn't assume the obligation of the plaintiff. That is right, isn't it?

Mr. Yerke: That is all, Mr. Cunningham.

#### Cross Examination

Q. (By Mr. Anderson): Mr. Cunningham, did you attempt to hire Mr. Adams as manager for Sutherlin Plywood? [180]

A. No. We needed no manager at the time.

Q. But he did apply for the job?

A. That is right. He was sent to me or referred to me by a mutual friend, Mr. George Hanford of the Lacey Plywood Company.

Q. Did you have any manager at that time?

A. No. He had heard that Mr. Patterson had left the organization.

(Testimony of Eugene F. Cunningham.)

Q. At that time you had no manager?

A. That is right.

Q. And Mr. Adams presented himself to you and asked for the job as manager? A. Correct.

Q. Did you advise the other members of the Board of Directors of that fact? A. I did.

The Court: When was that?

A. Shortly after Mr. Patterson had left. I think possibly a couple of weeks. I would say it was about the first of June or middle of May.

The Court: That was after the plant had shut down? A. That is right.

Q. (By Mr. Anderson): You were familiar with Mr. Adams' operating background, were you not?

A. Only in geenral, what Mr. Hanford had told me, what he told me of it. I hadn't been acquainted with the gentleman [181] prior to that.

Q. You knew something about him, though, didn't you?

A. I had never heard of him prior to that.

Q. Actually, you knew he was a crackerjack in plywood, didn't you?

A. No, I didn't. I don't know that he is a crackerjack yet. He may be, but I don't know it.

Q. Were any discussions had by the board about hiring Mr. Adams as manager?

A. No. We had no need for a manager at that time, because there wasn't anything he could do. We were out of money completely and we couldn't operate until we arranged finances.

(Testimony of Eugene F. Cunningham.)

Q. Actually, what you needed most of all was a manager, wasn't it?

A. No, sir. What we needed was some finances. We had creditors on our neck, and there was nothing we could do about it.

Q. Did you ever advise Mr. Hofheins that you could hire Mr. Adams as manager?

A. Yes, I did.

Q. When did you advise him that?

A. On one of our telephone conversations I mentioned the fact that he was available.

Q. What date?

A. Oh, I would say it was probably mid-June or somewhere around [182] there, the first of June or somewhere in that neighborhood. We had several conversations from time to time. I don't recall the date of it.

Q. Was there any discussion of hiring Mr. Adams as manager at the meeting on July 28th which Mr. Hofheins attended? A. No, no.

Q. Mr. Cunningham, when did you start receive these legal opinions that you talked about?

A. I would say my first call was about, oh, mid-June, or somewhere in that neighborhood, investigating the possibilities.

Q. Those opinions were discussed at the subsequent board meetings?

A. Ultimately we compared notes on all of the opinions that we had gotten, and they seemed to be more or less in line.

Q. Were those opinions discussed at the July 28th board meeting?



(Testimony of Eugene F. Cunningham.)

A. I don't think so. That is my best recollection that they were not at that time. We were concerned with other matters.

Q. Why weren't they discussed at the July 28th board meeting? A. Well, that I wouldn't know.

Q. Was it because Mr. Hofheins was present?

A. No.

Q. Was Mr. Hofheins advised about these opinions you were seeking? A. How is that? [183]

Q. Was Mr. Hofheins advised about these legal opinions you were seeking?

A. We had already had some opinions relative to the thing, and there was no particular thing that we needed to discuss in that respect.

Q. I take it your answer is that Mr. Hofheins was not advised that you were seeking legal opinions?

A. That is correct. He was not advised that we were seeking legal advice.

Q. Was Mr. Hofheins ever advised that you questioned the contract or sought an interpretation of it?

A. I don't believe I quite understand your question.

Q. Was Mr. Hofheins ever advised that you were seeking legal advice or that you were concerned about the legal validity of the sales contract?

A. I don't think I ever advised him, no.

Q. Did anybody on the board advise him?

A. As far as I know, they didn't. I don't know. I can only speak for myself.

(Testimony of Eugene F. Cunningham.)

Q. Now you testified on your direct examination about a discussion in a board meeting about shutting down the plant. What was the date of that meeting?

A. March 28th, I believe.

Q. Is it your testimony that there was discussion of shutting down the plant at that meeting?

A. Well, Patterson was ordered at that meeting to not purchase any additional veneers and to work out the pile that was on hand. I think there was some discussion relative to shutting down the plant. I doubt if at that meeting there was a definite order to shut down the plant, but I think there was some discussion, however, at that time of the possibility that we might have to shut down.

Q. You say you think there was some discussion. Do you know where there was or not?

A. I am sure there was.

Q. Weren't the instructions that were given at that meeting to use up the veneer that was in the plant before buying more veneer?

A. Yes, they were. That was the instructions to Mr. Patterson.

Q. And there weren't any instructions issued to him to shut down at that meeting?

A. I don't believe there was. In fact, I am sure there were not.

Q. Now I think you said on your direct testimony that Mr. Hofheins at that meeting never objected to the shutdown. Actually, the question never was directly presented, was it?

A. Whether it was authorized or not at that time, I can't rely upon my recollection too much,

(Testimony of Eugene F. Cunningham.)

but I think the minutes speak for themselves. If there was an order to shut down the plant at that time it should be in the minutes. [185]

The Court: I don't think that was the testimony, anyway. The question was did Mr. Hofheins object to the direction given to Mr. Patterson not to buy any more veneer until he had used the rest of the veneer. That was the question.

Mr. Anderson: I was under the impression the testimony was whether Mr. Hofheins objected to shutting down. If that was it——

A. I think we all agreed at that time that the company was broke and that something would have to be done and we should work out the stockpile that was on hand. I don't think there was any question about that. There was no disagreement on the subject.

Q. (By Mr. Anderson): Mr. Cunningham, as Chairman of the Board of Directors did you feel an obligation to make this company perform under its sales contract?

A. As, if and when it produced plywood.

Q. How much time did you spend with the company?

A. I can't tell you. I spent a good deal of time there. There were numerous trips down there, and I spent a great deal of time. I should say perhaps I spent as much as three months continuous service for the company over the period of a couple of years.

The Court: What were you paid for your services?

(Testimony of Eugene F. Cunningham.)

A. Nothing. There never was any charge for that. I have never been compensated in any way. I don't expect to be. [186]

Q. (By Mr. Anderson): One further question, Mr. Cunningham. When was it you first learned that Mr. Adams was available as a manager?

A. I believe it was the latter part of May or early June or middle of May, somewhere around there. If my recollection is correct, Mr. Patterson left on May 1st, and it was something like a couple of weeks later that Mr. Adams dropped into my office at Tacoma and talked to me about a job as manager. The exact date I couldn't tell you.

Q. The next meeting, I take it, would have been the creditors' meeting or, rather, the shareholders' meeting on June 12th? A. Yes.

Q. Did you advise the shareholders that Mr. Adams was available as a manager? A. No.

Q. You did not? A. No.

Q. Was any discussion had at that meeting about——

A. Not relative to managers. Not relative to managers.

Q. Was there a directors' meeting held at the same time?

A. It seems to me that there was a day difference between.

Q. But on or about the same time? A. Yes.

Q. At the directors' meeting was there a discussion had about hiring Mr. Adams as a manager?

A. Well, there was mention of it, yes.

Q. What was the reaction?

(Testimony of Eugene F. Cunningham.)

A. The reaction was what use is a manager, when we are in this kind of a fix?

Q. Now Mr. Cunningham, with your veneer purchases financed all you had to do was to arrange for the payroll financing, wasn't it?

A. Yes, but who would we arrange with?

Q. Well, that was the job, wasn't it, to arrange for the payroll financing?

A. Payroll and other items, pay off some of the bills we had and keep the power going. I think there was something like \$1500 required to get the power turned on again at that time. And there were numerous other items, and we had some \$45,000 in creditors.

Q. Didn't you receive offers from Oregon Plywood Sales Corporation for you to submit a plan and that they would cooperate with you in any way they could to get you going? A. No.

Q. Did you read the correspondence that came to Sutherlin? A. Yes, sir.

Q. Didn't you receive a letter in May from Franklin Hofheins asking you to submit a plan and telling you that he would cooperate in any way possible?

A. Yes. Bob and I had several conversations about it and [188] that ended the matter.

Q. There was never any reluctance on the part of Oregon Plywood Sales to arrange for the green veneer financing, was there? A. No, sir.

Mr. Anderson: That is all.



(Testimony of Eugene F. Cunningham.)

Redirect Examination

Q. (By Mr. Yerke): Why didn't you reopen then?

A. Obviously, we had no money to reopen.

Q. Did you attempt to find additional sources of money? A. Yes, sir.

Mr. Yerke: That is all.

Recross Examination

Q. (By Mr. Anderson): Mr. Cunningham, what happened to the market in the summer of 1954?

A. The market was steadily sliding down until the strike occurred, and then I would say that it steadied up for a while and finally commenced to react upward.

Q. When that happened you had opportunities to sell the plant, and rather than put in any more time on it you decided you wanted to get your money out of it that way. Isn't that what happened? When the opportunities arose with the market rising [189] you decided that you wanted to sell the plant?

A. No, no. I would say the stockholders decided that. I didn't decide it.

Q. Who raised that matter at the June meeting suggesting the sale? A. I did. I told——

Q. You were the one who initiated the idea, weren't you?

A. I told the stockholders exactly what the situation was, and that if we didn't sell it or lease it or take some definite action at that time that there

(Testimony of Eugene F. Cunningham.)

would be either a receivership or bankruptcy, in my best opinion, unless the crowd were willing to raise some money so that we could get started again. The matter of some the boys working for awhile for practically no wages was discussed, and the amount of money that was apparently offered at that meeting was so insignificant that there seemed no possibility whatsoever of getting the plant in operation. Many people on the floor discussed the thing and brought their ideas in front of the meeting and nothing happened. The ultimate result of it was that we decided either to sell the thing or lease it at that time, whatever we could do.

Q. What was the extent of your holdings in Sutherlin Plywood?

A. I don't know exactly. It is something in excess of \$175,000.

Q. At the time you made this sale Sutherlin had a very substantial net worth, did it not?

A. Are you referring to bookkeeping or actual values? [190]

Q. I am talking about the net worth as shown on the books, which I assume to be correct.

A. Book value, yes. It had considerable book value.

Q. Between three and four hundred thousand dollars, wasn't it?

A. I imagine so. I don't know the exact figure.

Q. They were not broke, by any means?

A. I considered them so. It is all the point of

(Testimony of Eugene F. Cunningham.)

view, I guess. If they have no cash and are insolvent, are they broke? That is the question.

Q. All they needed to get going was a month's payroll? A. Sir?

Q. All they needed to get going was a month's payroll? A. All they needed was some money.

Mr. Anderson: All right. That is all.

### Redirect Examination

Q. (By Mr. Yerke): Have you gotten any return on your stock yet? A. None whatsoever?

Q. When do you expect to get something back on it?

A. I think about 18 months from now, or two years maybe.

Q. Do you know whether or not the capital of Sutherlin Plywood Corporation was impaired at the time of the sale? A. It was.

Mr. Yerke: That is all.

Mr. Anderson: That is all.

(Witness excused.) [191]

### JOHN RICHARD ADAMS

was produced as a witness in behalf of the Defendants and, having been previously duly sworn, was further examined and testified as follows:

### Direct Examination

Q. (By Mr. Yerke): Mr. Adams, you testified yesterday, didn't you? A. Yes.

Q. Did you apply for a job as manager of the plant at one time?

(Testimony of John Richard Adams.)

A. At the time I heard that Mr. Patterson was no longer going to be with the plant I went down to look it over, and I think there was some discussion as to managing the plant.

Q. You and Mr. Jacobson ultimately submitted an offer for the plant, did you not?

A. That is right.

Q. Did you ever attempt to lease the plant? Did you negotiate on that particular basis?

A. Yes, our first negotiations were on the basis of a lease, a lease for so much a thousand on what we could produce.

Q. Whom were you dealing with as far as these negotiations were concerned?

A. Principally Mr. Cunningham.

Q. Where were the negotiations occurring then?

A. I think in Tacoma.

Q. In connection with your negotiations for a lease did you ever seek legal advice concerning the effect of the sales contract? [192]

A. Yes, I did.

Q. Whom did you consult?

A. The law firm of Carson & Newland in Tacoma, Washington.

Q. Did you obtain a written opinion from them?

A. Yes, I did.

Q. In connection with the actual sale of the assets who represented you and Mr. Jacobson?

A. An attorney in Seattle, Snyder King.

Q. Did you seek advice from Mr. King on the effect of the sales contract on a possible purchaser of the assets?

A. Yes, we did, verbal advice.

(Testimony of John Richard Adams.)

Q. Since Nordie Plywood, Inc., commenced operating the plant have there been many changes as far as equipment is concerned?

A. There have been any number of changes. We have added quite a lot more equipment and increased the capacity of the plant.

Q. Are you in charge of the production of the plant today?           A. No.

Q. What is your business down there?

A. I handle the sales and the office.

Q. Is the plant making money at the present time?           A. Yes.

Q. Has it lost money at all since it commenced operating?           A. Yes, it has.

Mr. Yerke: That is all. [193]

#### Cross Examination

Q. (By Mr. Anderson): Mr. Adams, how much capital did you put into this business?

A. Our capital was \$50,000.

Q. That was the total amount, was it not?

A. No.

Q. Between you and Mr. Jacobson?

A. That was our total investment, although we had help otherwise.

Q. Do you have an arrangement where anybody purchases your green veneer for you?           A. No.

Q. That \$50,000 would not buy a half a month's supply of green veneer, would it?

A. Well, I wouldn't say that.

Q. All right. It wouldn't buy a month's supply, would it?



(Testimony of John Richard Adams.)

A. We don't buy a month's supply all at once.

Q. Would it buy a month's supply?

A. Well, you just don't buy a month's supply. You buy by weeks.

Q. Just answer the question whether it would or would not buy a month's supply.

A. No, it would not.

Q. Do you have a sales contract?

A. We have a sales contract on part of our production, yes.

Q. What is the discount—I withdraw that. That has nothing [194] to do with it.

The Court: It doesn't make any difference to me. Did you get finances from any other source?

A. Yes, we did.

Q. (Mr. Anderson): You financed through the bank, didn't you? You are now financing through the bank, are you not?

A. We finance our accounts receivable through the bank, yes.

Q. Now these equipment changes that you are talking about, the really major equipment change was the addition of a new drier last spring or last summer, was it not, an additional drier?

A. The additional drier, press, glue machine, jitneys and buildings.

Q. Isn't it correct that when you started up you started up with what was in the plant?

A. That is right .

Q. Isn't it correct that within the first three months you showed a profit of over \$20,000?

(Testimony of John Richard Adams.)

A. Well, I don't remember the exact figures.

Q. Whatever is shown on the balance sheet?

A. That is right.

Q. Whatever is shown on the balance sheet of your company is the profit you show?

A. That is right.

Q. You recall that you got into the black within the third month, do you not? [195]

A. Yes, we were in the black after the third month.

Q. You made the payments on the mortgage of \$5500 every month?

A. That is right.

Q. You have been charging depreciation at what rate?

A. Well, it is whatever the accountants have set up. I don't know the exact rate.

Q. Whatever is shown in the accounting records?

A. Yes.

Q. So you have not only made a profit but have been able to pay \$5500 a month on the loan and you have made substantial charges for depreciation?

A. The figures will show what we have done.

Q. What are your prospects now on a five-year basis?

A. I couldn't tell you.

Mr. Anderson: That is all.

#### Redirect Examination

Q. (By Mr. Yerke): You lost money the first few months that you operated, didn't you?

A. I think the first month we operated we lost money.

(Testimony of John Richard Adams.)

The Court: The books would show.

Mr. Yerke: That is right, your Honor. No further questions.

The Court: I don't think it makes any difference, anyway.

(Witness excused.) [196]

### NORMAN H. JACOBSON

was produced as a witness in behalf of the Defendants, and, having been previously duly sworn, was further examined and testified as follows:

#### Direct Examination

Q. (By Mr. Yerke): You testified yesterday, did you not, Mr. Jacobson? A. Yes, I did.

Q. How long have you been in the plywood business? A. About 35 years.

Q. What was your last position with a plywood organization prior to the time that you commenced working down at Nordic Plywood?

A. I was with the Astoria Plywood at Astoria.

Q. For how many years?

A. About three years and a half, I think.

Q. In what position? A. I was the manager.

Q. Have you ever been a superintendent in a plywood plant? A. For some twenty years, yes.

Q. When did you first see the mill down at Sutherlin? A. The week after July 4th.

Q. Of 1954? A. That is right.

Q. Did you inspect the mill at that time?

A. I did, yes. [197]

Q. Did you talk to anyone down there?

A. Only the watchman.

(Testimony of Norman H. Jacobson.)

Q. What did you see as far as the machinery was concerned?

A. Well, naturally that was the first thing I looked at. I know that some of the machinery—some of the fork lift trucks were old, and the tapping machine, which is a very vital machine for the mill, was not a very good type.

Q. Why not?

A. Because it was originally made for hardwood, which is a thin wood, and wouldn't do so well on fir wood, as proven out later.

Q. Fir, of course, is a soft wood, is it not?

A. That is right.

Q. What was the condition of the press?

A. The press was of German make, and the wiring which we had to replace later caused us a great deal of trouble and loss of money. We re-wired the press as soon as we found out what had to be done, and since then we have had no trouble with it.

Q. How many openings did the press have?

A. Fifteen.

Q. What is an opening, incidentally? What is the function?

A. That is where they place the panels. If there are 15 openings then you are making 15 panels. You have one panel between each opening. That is the extent of your production in the press. [198]

Q. Is that a desirable number of openings?

A. No, most plants have about 20 openings.

Q. Would that be a disadvantage?

(Testimony of Norman H. Jacobson.)

A. Yes, it would as far as production is concerned.

Q. Why is that?

A. Because you would be limited as to how many panels you could make in a given period of time.

Q. How much per day, if you know?

A. It would run around 900 panels a day, and figuring on 4 by 8 panels, that would be 32 foot to a panel, so you would multiply that by nine and you would have it,—practically a carload of plywood during 24 hours.

Q. Now did you encounter any difficulties with this equipment after you started operating with it?

A. Yes, we did. What we thought when we looked the mill over was borne out later when all this equipment was replaced. The lift trucks, which are very important to a mill, were replaced. We bought four new lift trucks—five new lift trucks. We replaced the taping machine. We also rewired the press, and we had to replace all the bearings in the drier which had disintegrated, and we rearranged quite a bit of the machinery to make it more efficient.

Q. You say you replaced the taping machine. What is the taping machine used for?

A. It is used for narrow strips to make a wide piece of veneer. [199]

Q. Now you mentioned that the bearings in the drier had to be replaced. Why was that?

A. Because they were a new type bearing and



(Testimony of Norman H. Jacobson.)

they wouldn't stand up under the heat that was in the driver.

Q. What would happen to the bearings?

A. They would disintegrate and the rollers would drop down and the rollers would plug up.

Q. Now have you made any changes down there other than the ones that you referred to as far as the operation was concerned?

A. Yes. If you consider buildings, we have made or provided more floor space. We have added a shop, which they didn't have, and we have rearranged — like I said before, we rearranged a lot of machines, and added a drier and a press and the glue machine. And we have added a tenoner for tongue and groove plywood.

Q. What is a tenoner?

A. It is a machine that is used for tongue and grooving shiplap or plywood.

Q. Did you say that you had added a new drier and a new press?           A. That is right.

Q. Have you rearranged any of the machinery?

A. We have, yes, lots of it.

The Court: All right. Go to another subject.

Mr. Yerke: Just one other question, I think, your Honor.

Q. When was the new machinery put in; that is, the new drier [200] and the new press?

A. During the month of August, 1955.

Q. 1955?           A. That is right.

Mr. Yerke: That is all.

(Testimony of Norman H. Jacobson.)

Cross Examination

Q. (By Mr. Anderson): Mr. Jacobson, all these changes that you have made, you have done that with the money that came in through the business?

A. No, I won't say that. A lot of the machinery has been bought on contract.

Q. All right. But you haven't put in any more capital other than the original fifty thousand?

A. Yes, we have. We put in some more capital.

Q. That was in small amounts?

A. We borrowed money ourselves and put it into it occasionally.

Q. Very small amounts?

A. Well, it wasn't so small. It had to be repaid. I think it was \$40,000.

Q. They were temporary loans, were they not? It wasn't that much at one time?

A. Yes. I think it was given to us in lots of \$10,000 as the work progressed on the mill.

Q. Those were loans from the bank; is that right? [201]

A. That is right, our own personal loans.

Q. You endorsed them on the corporation's note?

A. Yes, that is right. We make the payments ourselves.

Q. Now as a matter of fact, up until the time you put in the drier these repairs didn't amount to an awful lot in dollars, did they?

A. What kind of repairs?

Q. For instance the taping machine. Did you replace the taping machine?

A. Yes, we did.

(Testimony of Norman H. Jacobson.)

Q. What did that cost? A. \$3,000.

Q. How much? A. \$3,000.

Q. You bought that on contract, didn't you?

A. We did, yes.

Q. Do you remember the down payment?

A. 25 per cent.

Q. So that the things were small. As a matter of fact, you got the bearings furnished by the manufacturer, didn't you, for the drier?

A. That is true, but there was a labor item in there that was quite large in loss of time.

Q. It was done by your regular crew, wasn't it?

A. And the jitneys also cost us close to \$10,000.

Q. All that was paid for out of the operation?

A. Well, it is being paid for out of our operation.

Mr. Anderson: All right. That is all.

### Redirect Examination

Q. (By Mr. Yerke): You say you had a large labor item to replace these bearings furnished by the manufacturer? A. Yes, sir.

Q. What do you mean by that?

A. There is about a thousand bearings in a drier, and they had to be replaced manually. It takes a lot of time and work to do that. They had to be replaced on a week end, which is time and a half.

Q. Does the drier ordinarily operate on a seven-day week? A. It does.

Mr. Yerke: That is all.

(Witness excused.) [203]

## RAYMOND M. WARD

was produced as a witness in behalf of the Defendants and, having been first duly sworn, was examined and testified as follows:

## Direct Examination

Q. (By Mr. McClanahan): What is your occupation? A. I am a certified public accountant.

Q. Are you licensed to practice in Oregon?

A. I am.

Q. How long have you been licensed in Oregon?

A. Since 1921.

Q. What is your experience in accounting?

The Court: Oh, if he is a certified accountant why is it necessary to qualify him?

Q. (By Mr. McClanahan): Did you ever practice in Roseburg? A. I did.

Q. Did you have any contacts with the defendant Sutherlin Plywood Corporation in your practice? A. I did.

Q. Over what period of time did you have contacts with Sutherlin?

A. Sutherlin Plywood Corporation contacted the firm with which I was employed the first part of December, 1953.

Q. Did you do any work for them?

A. We audited the records and prepared financial statements as a result of that audit as of December 31, 1952. [204]

Q. What else did you do besides auditing the records?

A. We issued another report as of December 31, 1953, because of the year end, and as of the first

(Testimony of Raymond M. Ward.)

of the year 1954 they commenced operations and they required a system to reflect the results of the operations, and I set up an accounting system and records and supervised the recording of transactions for the first month and followed through with the preparation of financial statements.

Mr. McClanahan: Would you hand the witness Exhibit 143, please.

Q. Now the biggest bunch of yellow papers there, what is that?

A. 143-C. They are working papers prepared by me in connection with the review of the records.

Q. From where did you get the information that is contained in these?

A. I obtained this information directly from the sales invoices to Oregon Plywood Sales Corporation and copies of the sales invoices from veneer purchase invoices and from duplicate deposit slips.

Mr. Anderson: May I inquire if this is for the purpose of qualifying the financial statement? If it is——

Mr. Yerke: No, it is not. It is merely to tie up, Mr. Anderson, for the purpose of the record just what these are. They are in evidence already, but I just wanted to get something in the record to indicate what they are. [205]

Mr. Anderson: For what purpose?

Mr. Yerke: That is in connection with the counterclaim.

Mr. Anderson: As I understand it, there is no



(Testimony of Raymond M. Ward.)

dispute about the credits for the veneer purchases which he is testifying about now.

The Court: What is the counterclaim? I don't know what the counterclaim is.

Mr. Anderson: That is just an open account. We call it the open account claim. They call it a counterclaim. There are various debits and credits between the parties.

The Court: Is it a matter of judgment at all, or is it just a matter of items of bookkeeping entries?

Mr. McClanahan: It is to some extent a matter of dispute as to the items, such as the assignment and other items. We can come to an agreement on most of the other things.

The Court: Isn't all the evidence in on the assignment?

Mr. Yerke: Yes, your Honor.

The Court: I hold against you on the assignment, so you can start with that.

Mr. Yerke: This testimony here has relevance to other matters, your Honor. It has relevance to connecting these documents which are in evidence to reflect the financial condition and the relations which Sutherlin had to plaintiff.

Mr. Anderson: He is testifying about the green veneer purchases, as I understand. [206]

Mr. Yerke: He is not testifying about green veneer purchases. He is testifying about Exhibit 143. There are three documents in there and we want to connect them with each other.

(Testimony of Raymond M. Ward.)

Mr. Anderson: With regard to which item?

Mr. Yerke: In regard to the financial condition of Sutherlin and its relations with the plaintiff, which we submit, your Honor, is relevant in this lawsuit.

The Court: For what purpose?

Mr. Yerke: These documents, your Honor, will show, for instance, for one thing, whether the 80 per cent advance was made and when it was made by invoices which show that. Furthermore, it will show the treatment on the books of the various items testified about.

The Court: What is your counterclaim?

Mr. Yerke: Our counterclaim, your Honor, is for additional credit which we have not been given on the veneer purchases and for the balance due us for plywood sold to the plaintiff.

The Court: How much is your counterclaim?

Mr. Yerke: We wanted to amend the pretrial order on that, your Honor. The figure is \$4,515.03.

Mr. Anderson: We have no objection to the amendment.

The Court: All right. Now that I have decided against you on the assignment, what is your counterclaim?

Mr. McClanahan: If you reduce our claim on the counterclaim—if you find against us on the assignment we have no [207] counterclaim.

The Court: All right.

Mr. Yerke: It is then, of course, a matter of just what you determine we owe the plaintiff to the extent that the items have been proved.

(Testimony of Raymond M. Ward.)

The Court: All right. Now on the question of the financial condition of the company you don't need to ask him any questions. I know what the financial condition was. The books and records show that.

Mr. McClanahan: No further questions.

The Court: Do you have a financial statement as of March or April?

A. I have one of January 31st, February 28th, March 31st, April 30th and May 31st also.

The Court: May 31st? A. Right.

The Court: What number is that?

Mr. Yerke: That is Exhibit 131, your Honor.

The Court: Let's take a look at that.

Q. (By Mr. McClanahan): 131-G. Does this report, Exhibit 131-G, accurately reflect the condition of the business as taken from the books and records of the company? A. It does.

The Court: Was it done in accordance with good accounting practice? [208] A. It was.

The Court: All right.

Mr. Yerke: That is all, your Honor.

#### Cross Examination

Q. (By Mr. Anderson): I have just one question, Mr. Ward. Were you charging depreciation in these accounts?

A. Which account are you referring to? You are referring to Sutherlin Plywood?

Q. Yes, Sutherlin.

A. Yes, we set up those depreciation schedules.

Q. What method of depreciation did you use?

(Testimony of Raymond M. Ward.)

A. Straight line.

Q. What period of time?

A. Well, it varies. As I recall—I am not too sure of this and I would have to refer to my working papers—as I recall we probably set up 12 years on the buildings and probably 10 years on the machinery and equipment and probably five years on the lift trucks.

Mr. Anderson: That is all.

Mr. McClanahan: No further questions.

The Court: Let me ask one other question. Can you tell from this Exhibit 131-G whether the company was in a position to pay its ordinary current liabilities in the ordinary course of business?

A. Well, this statement shows cash of \$409.00, and it shows the current liabilities over here of \$124,136.10. It shows a small amount of inventories which could be liquidated into cash. How much cash I can't tell by looking at this. It shows some stock subscriptions receivable which have been cancelled. They didn't receive any cash for those. And it shows accounts receivable broker and accounts receivable other in amounts of \$5,570.79 of accounts receivable broker and \$8,147.54 accounts receivable others. However, I am of the opinion that those were not all fully collected.

The Court: All right.

#### Further Cross Examination

Q. (By Mr. Anderson): Mr. Ward, you also have in here as current installments 12 months installments on the contracts and on the notes, do you

(Testimony of Raymond M. Ward.)

not? A. Yes, that is correct.

Q. But all those were not due at the time this was prepared? What we call current is something coming due within 12 months?

A. Those are all due within 12 months.

Mr. Anderson: All right.

#### Redirect Examination

Q. (By Mr. Yerke): Most of those were due at that time, weren't they, because [210] of defaults?

A. Some of these were delinquent. They had missed two or three months' payments.

#### Recross Examination

Q. (By Mr. Anderson): Just a minute, Mr. Ward. You say most of those were due?

A. Most of them couldn't have been due because this was only May 31st.

Q. As to some of them—for instance, the corporation note, which is \$1,000 a month, you have \$12,000. It indicates that only \$1,000 was due?

A. Yes.

Mr. Anderson: That is all.

(Witness excused.)

Mr. Yerke: We will reoffer at this time, your Honor, Defendants' Exhibit 128-A.

The Court: What is it?

Mr. Yerke: That is a letter from Mr. Hamby, who testified this morning, to Oregon Plywood Sales Corporation, I believe dated April 14th, 1954. I believe you have examined this, Mr. Anderson.



Mr. Anderson: Mr. Yerke, we have dropped the claim to which this letter relates, about the 5 per cent that was given [211] to somebody else. The \$1260 item has been deleted

Mr. Yerke: All right. You are dropping the claim. We withdraw the offer in that event.

Mr. Anderson: We dropped that \$1260 item, yes.

Mr. Yerke: We also offer at this time, your Honor, Exhibits 129-A through 129-F. Those are the letters from Mr. F. A. Hofheins and Mr. Robert H. Hofheins.

The Court: What do they refer to?

Mr. Yerke: They refer to a variety of matters. Mr. Anderson has examined these.

Mr. Anderson: I have no objection. I think they are already in as plaintiff's exhibits.

The Court: They may be admitted.

(The correspondence above referred to was received in evidence as Defendants' Exhibit 129-A to 129-F, inclusive.)

Mr. Yerke: We also offered this morning and Mr. Anderson objected to Defendants' Exhibit 136. I don't believe there was any ruling on that. That is a letter, your Honor, from Attorney Newlands to Mr. Adams concerning the legal effects of the contract upon a lease of the plant.

The Court: Any objection?

Mr. Anderson: The objection, your Honor, was raised. I don't see any materiality to it.

Mr. Yerke: Once again, we offer it only from the standpoint [212] of the good faith of defendant

Nordic Plywood Company in the dealings it had with the other defendant.

The Court: All right. I will admit it for that limited purpose.

Mr. Yerke: Thank you, your Honor.

(The letter above referred to was received in evidence as Defendants' Exhibit 136.)

Mr. Yerke: Then we also offer Exhibit No. 137, which is a letter from a firm of attorneys to defendant Sutherlin Plywood Corporation concerning one of the conditional sales contracts.

The Court: That is all right. It may be received.

(The letter referred to was received in evidence as Defendants' Exhibit 137.)

Mr. Yerke: I am not sure, but we will reoffer just for the purpose of the record Exhibits 131 and 132.

The Clerk: They are already received.

Mr. Yerke: The defendants rest, your Honor.

The Court: Go ahead.

Mr. Anderson: If the Court please, there still remains the item of \$1526 in dispute.

The Court: About what?

Mr. Anderson: That concerns orders which were accepted and acknowledged by Sutherlin, and the plaintiff was committed to its customer. The plaintiff had to place those orders elsewhere and was unable to do so at the 5 per cent discount. It [213] had to pay out the money and it did so and lost that money.

Mr. Yerke: We have stated our position on

that, your Honor. They are suing on a supposed open account and it is an unliquidated claim.

Mr. Anderson: We are prepared to put on testimony on that at this time, your Honor. There are five orders involved, and Mr. Thompson is fully familiar with that, I think.

The Court: Under the form of pleading we use here is there any reason why a tort claim cannot be joined with a contract action?

Mr. Anderson: None that I know of.

Mr. Yerke: No, there is no reason, your Honor. It is just a matter of the theory that is embraced in their contentions. They allege there is due them upon an open account a certain sum.

Mr. Anderson: If there is anything wrong with the contention I would like to move the Court to amend. We have been litigating this point all through the trial. I would like to move to amend to include these items which are included in our summary.

The Court: What about that?

Mr. Yerke: Oh, we won't oppose any amendment.

The Court: You can amend. I was going to let you do it, anyway. [214]

### HENRY L. THOMPSON

was recalled as a witness in behalf of the Plaintiff, in rebuttal, and was further examined and testified as follows:

#### Direct Examination

Q. (By Mr. Anderson): Mr. Thompson, I am showing you part of Exhibit 10 and I will ask you if

(Testimony of Henry L. Thompson.)

you wrote a letter dated April 20th to Sutherlin Plywood.       A. I did, sir.

The Court: Mr. Yerke, have you seen all this correspondence?

Mr. Yerke: I don't think I have seen all of it, no. May I come up too?

The Court: Yes, come up and take a look at it. Is there any question about the fact that these orders had been received and that they were filled by the company?

Mr. Yerke: I don't think we can take issue with the facts that he would testify to.

The Court: All right. What is your final result?

Mr. Anderson: Well, the result is included in the letter.

Mr. Yerke: Why don't you just tell the Court the conclusion that Mr. Thompson would testify to, and we will stipulate that if he is called he would so testify.

Mr. Anderson: What he would testify to, your Honor, is that there are these five orders which were placed or had to be placed elsewhere at greater expense because they were [215] obligated to the customer, and the total is \$1226.

The Court: All right.

Mr. Anderson: It is set forth in his letter.

The Court: Your letter is admitted and the testimony is admitted. That is, it is stipulated that Mr. Thompson would so testify.

Mr. Yerke: That he would so testify. That is right.

(Testimony of Henry L. Thompson.)

The Court: Let me ask one question. When were these orders placed?

A. Some of them in March, the early part of March and the middle of March, I believe.

The Court: The early part and middle of March. And the plant closed April 21st?

Mr. Yerke: That is right, your Honor.

The Court: Were they for the regular type of material? A. Just regular type orders.

The Court: Quarter inch?

A. Oh, various sizes.

The Court: Standard sizes? A. Yes, sir.

The Court: All right.

Q. (By Mr. Anderson): At any rate, they were accepted?

A. They were acknowledged in March.

(Witness excused.) [216]

The Court: Any further testimony?

Mr. Anderson: The plaintiff has no further testimony.

May I inquire one more thing? I believe in walking up to court Mr. McClanahan and I decided that on this open account claim we have only three items now in dispute, the \$1526 item, the \$336 item and the assignment. The assignment has been ruled upon. That leaves only two.

Mr. McClanahan: I misspoke myself, Mr. Anderson. There is an additional item for one per cent on the discount on the veneer purchases which we have not received credit for. There is a difference between us on that of \$1123.33. We contend that



it is normal in the plywood industry to give a one per cent discount on all veneer purchased. In this case that was the situation except for the Lake Pleasant invoices, on which we are entitled to 2 per cent and which we received. This \$1123.33 is for additional discount on the veneer, on the invoice price of the veneer, which we did not receive.

The Court: Did Oregon Plywood Sales receive them?

Mr. McClanahan: I understand that they contend they did not. We contend that under the contract they were duty bound to take them, and not to charge us for them if they didn't.

The Court: You mean even if they didn't get the discount they were to give you the discount?

Mr. McClanahan: That is correct, your Honor. We believe that is manifested in the loan agreement provision for the [217] veneer. After all, your Honor, this was a promise to advance money so we could buy veneer.

Mr. Anderson: I want to ask Mr. Hofheins a question, if I may ask him here.

The Court: Yes.

### ROBERT HOFHEINS

was recalled as a witness in behalf of the Plaintiff, in rebuttal, and was further examined and testified as follows:

#### Direct Examination

Q. (By Mr. Anderson): Did you credit Sutherland with all the discounts that you received on the

(Testimony of Robert Hofheins.)

green veneer purchased, and does that come up with a net figure of \$214,346.83?

Mr. Yerke: Objected to on the grounds no proper foundation has been laid.

The Court: Objection overruled.

A. Yes, sir.

Mr. Anderson: That is all.

(Witness excused.)

The Court: Mr. Anderson, did you see the cases that Mr. Yerke cited in his brief? Did you read them?

Mr. Anderson: Which brief are you speaking of, your Honor?

The Court: That is the defendants' memorandum on Sutherlin [218] Plywood Corporation's right to terminate production and sell its mill.

Mr. Anderson: Yes, I think I have read most of those cases, your Honor, the ones which are in conflict with the cases we presented.

The Court: Mr. Anderson, I don't think there is any use for me to study this. I am ready to decide this case.

Mr. Anderson: If there is any doubt in your Honor's mind——

The Court: There is no doubt how I am going to decide it.

Mr. Anderson. ——I would like to present a brief on the legal points involved. I think there is adequate authority in Oregon and in the Ninth Circuit——

The Court: Mr. Anderson, you have been forget-

ting all the time about Mr. Hofheins' obligation. He was a member of the Board of Directors of this corporation. He wasn't just a man who was sitting by. It seems to me that when things were going bad he had some duties to perform, and he just couldn't sit idly by when his company was secured and he didn't have a chance of losing any money and complain about the fact that all these working people in addition to—I have forgotten this man's name who was president of the company who had all this money in the corporation. You couldn't expect him to do all the work. It seems to me the evidence is very clear in this case that the defendant Sutherlin Plywood Corporation had the alternative of selling its plant or going broke. I [219] don't think that it had any opportunity of complying with this contract. The time for compliance had long since passed when they closed up shop.

I am going to construe the contract that was entered into, this output contract and this requirements contract, as indicating that they would ship 80 per cent of their production during all the time that they were in production, but that if conditions made it unprofitable or if for other reasons they couldn't produce then they were relieved of that obligation. I think the evidence is clear, too, that it was just folly for them to try to continue in view of the financial condition with which they were faced.

Mr. Anderson: Is your Honor holding that financial difficulties are an excuse for performance?

The Court: Yes, I am holding precisely that;

that this company could not have performed and had no opportunity to perform. And I hold here that all of the directors acted in good faith, and that the condition with which they were confronted excused further performance by Sutherlin Plywood Corporation. And, as I have indicated before, I think there is absolutely no merit to the contention that the Nordic Plywood would be bound by this contract. Here is a situation in which none of the former directors and stockholders of Sutherlin Plywood Corporation were in the new company. There was no collusion between these two organizations, nor do I [220] think that they acted in bad faith. And I say that even without regard to the legal opinions which they received to that effect, and in which I place no credence.

I have already stated here that I think the assignment was not in payment; it was merely a security transaction; and that Oregon Plywood Sales is entitled to that amount. I also am of the opinion that Oregon Plywood was not required to give them greater discounts on the green veneer than they actually received. Mr. Hofheins testified that he gave them all the discounts that he got, and he did not get this one per cent, so I am not going to give it to the defendants.

Now with reference to the \$333, I think that the evidence is undisputed that the plaintiff actually put that money out and gave credit for that amount, and I am going to allow that.

The only one that I have any doubt about is the question of the liability for orders which were ac-

cepted and not filled. Mr. Yerke, were there other orders which were not filled, or why weren't these orders filled?

Mr. Yerke: We are not certain, for one thing, your Honor, about the orders in question. The second thing is we don't know, to be perfectly frank.

The Court: You see, the thing is that these are not orders which were placed just prior to the time the plant closed. Mr. Thompson testified that many of these orders were [221] placed during the early part of March. The plant did not close until the 31st.

As to orders which were placed and accepted I am going to hold that the plaintiff is entitled to recover for the damages it sustained. That is fifteen hundred——

Mr. Yerke: \$1526.

The Court: All right. The plaintiff can have that.

I am not going to allow costs to either party because of the failure of the plaintiff to substantiate its primary claim. Each party will bear its own costs.

Is there any other item here?

Mr. Yerke: Do you wish us to prepare the findings, your Honor?

The Court: You can prepare the findings, and you prepare your findings on your side of the case if you wish, Mr. Anderson. If you want to prepare the findings on the counterclaims, that is all right.

Mr. Anderson: The Court has indicated its feeling on this and I hesitate to delay the matter, but



I do feel that there are two points of law upon which I would like to present authorities.

The Court: All right. You present them. But I will decide the way I have.

Mr. Anderson: Yes, sir.

The Court: You take that up with the Court of Appeals. [222]

Mr. Anderson: Yes, sir.

The Court: I have looked over these things. I just think there is no basis and no merit to your principal claim. I don't see any useful purpose in your presenting me with a brief, but you can do it if you want to.

Mr. Anderson: I have authorities to present as to whether financial difficulties are an excuse for non-performance of contractual obligations.

The Court: That is one of your grounds for appeal.

Mr. Anderson: Yes, sir. Of course, the other one is, which the Court did not say anything about, that even if they were not required to produce they still had no right to entirely disable themselves from performing this contract. That is our other point.

The Court: I am going to hold that at the time they closed up they had become disabled through no fault of their own and that the plaintiff, when it entered into the contract with the defendant, knew that the defendant was a weak organization that had very little financing, and that the plaintiff, being an experienced operator, was well aware of the hazardous character of the plywood market

and lumber companies, particularly organizations which were financed primarily by the employees, and knew or should have known of the difficulties of getting good management to conduct these organizations, and that it was certainly within the contemplation of the [223] plaintiff that this company might not be able to withstand the rigors of competition in view of all the circumstances with which a company of this kind might be faced.

Mr. Anderson: What we didn't think of, your Honor, was that they would sell the plant and take the profits for themselves and leave us holding the bag.

The Court: I think that the evidence here shows that the only people that came out whole were your clients; that the other people are the only ones who suffered a loss.

(Whereupon proceedings in the above matter on said day were concluded.)

[Endorsed]: Filed Sept. 7, 1956. [224]

[Endorsed]: No. 15271. United States Court of Appeals for the Ninth Circuit. Oregon Plywood Sales Corporation, Appellant, vs. Sutherlin Plywood Corporation and Nordic Plywood, Inc., Appellees. Transcript of Record. Appeal from the United States District Court for the District of Oregon.

Filed: September 1, 1956.

Docketed: September 12, 1956.

/s/ PAUL P. O'BRIEN

Clerk of the United States Court of Appeals for the Ninth Circuit.

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In The United States Court of Appeals  
For The Ninth Circuit

No. 15271

OREGON PLYWOOD SALES CORPORATION,  
a corporation, Appellant,  
vs.

SUTHERLIN PLYWOOD CORPORATION, a  
corporation, and NORDIC PLYWOOD INC.,  
a corporation, Appellees.

### STATEMENT OF POINTS

The points upon which appellant intends to rely on this appeal are as follows:

1. The court erred in not finding that defendant Sutherlin Plywood Corporation breached its

contract with plaintiff and in failing to award damages for said breach of contract.

2. The court erred in not finding that defendant Nordic Plywood, Inc. interfered with and induced a breach of said contract between plaintiff and defendant Sutherlin Plywood Corporation and in not finding plaintiff entitled to damages and punitive damages therefor.

3. The court erred in not finding that defendants should be enjoined from operation of said mill until and unless they comply with the sales agreement with plaintiff.

4. The court erred in entering findings and conclusions:

(a) Concerning plaintiff's knowledge of defendant Sutherlin Plywood Corporation's ability to perform its contract with plaintiff.

(b) Concerning defendant Sutherlin Plywood Corporation's financial condition.

(c) That defendant Sutherlin Plywood Corporation was disabled from performance of the contract prior to the sale of its mill to defendant Nordic Plywood, Inc.

(d) That defendant Sutherlin Plywood Corporation acted in good faith in selling its mill which disabled it from further performance of its contract.

(e) That defendant Nordic Plywood, Inc., did

not induce defendant Sutherlin Plywood Corporation to sell its mill.

(f) That there was no collusion, conspiracy or agreement between defendant Nordic Plywood, Inc. and defendant Sutherlin Plywood Corporation to destroy plaintiff's rights in its sales contract.

(g) That defendant Sutherlin Plywood Corporation was relieved from honoring its contract with plaintiff if conditions made it unprofitable to continue performance.

(h) That defendant Sutherlin Plywood Corporation was excused from performance of its contract with plaintiff by reason of its financial losses.

(i) That defendant Nordic Plywood, Inc., was privileged to purchase the physical assets of defendant Sutherlin Plywood Corporation.

5. That the findings do not support the judgment.

KOERNER, YOUNG, McCOLLOCH  
& DEZENDORF

/s/ HERBERT H. ANDERSON

Attorneys for Appellant

Affidavit of Service by Mail Attached.

[Endorsed]: Filed Sept. 21, 1956. Paul P. O'Brien, Clerk.



[Title of Court of Appeals and Cause.]

### STIPULATION

It is stipulated by and between the parties hereto, acting through their attorneys, that the exhibits herein may be omitted from the printed record but shall be considered by the court in their original form as though set out in the printed record and appellant and appellees consent to the entry of an order so providing.

KOERNER, YOUNG, McCOLLOCH  
& DEZENDORF

/s/ HERBERT H. ANDERSON

Attorneys for Appellant

/s/ FREDRIC A. YERKE, JR.

Attorney for Appellees

Affidavit of Service by Mail Attached.

[Endorsed]: Filed Sept. 22, 1956. Paul P.  
O'Brien, Clerk.













